LIFE INSURANCE: ITS ECONOMIC AND SOCIAL RELATIONS
EDITED BY
SOLOMON S. HUEBNER

BUSINESS LIFE INSURANCE TRUSTS

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BUSINESS LIFE INSURANCE TRUSTS

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EDITOR'S PREFACE

The volume on *Business Life Insurance Trusts* is one of a series entitled "Life Insurance: Its Economic and Social Relations," which also includes volumes on *The Economics of Life Insurance; The Sociology of Life Insurance, Taxation, Education and Philanthropy; Wills, Trusts and Estates;* and *The Law of Salesmanship*. The purpose of the series is to provide a specialized life insurance literature, in textbook form, in the interest of (1) making available to many business and professional groups one or more books of large practical usefulness; (2) giving to teachers of the social sciences a special literature identifying life insurance with their subjects of specialization; (3) furnishing an opportunity for further systematic study to those who are pursuing the subject of life insurance in universities and colleges; and (4) offering a similar opportunity to those already engaged in the life insurance field.

To an ever increasing extent life insurance is reaching out to serve business men in the operation and the final liquidation of their business enterprises. The latter phase—that of liquidation—is of special significance to those who are sole proprietors of a business, or partners in co-partnership enterprises, or stockholders in close corporations. In nearly all cases it is vital to all concerned that there should be an equitable liquidation of the deceased's interest in the business, and in most instances a well arranged business life insurance trust is indispensable. It is therefore important, as regards such trust arrangements, to have an understanding of the law, the duties and obligations of the trustee, the

designation of the beneficiaries, the various methods of premium payment, the several plans of reimbursement, the different methods of valuation, the distribution of the policy proceeds, and the conditions under which taxation privileges may be secured. These and other allied subjects are treated comprehensively in the present volume, which should commend itself to bankers, trustees, legal advisers, and other advisory groups. Those engaged in the life insurance calling should also, in the interest of clients, be conversant with this important phase of life insurance service. For their special benefit the volume is also devoted in part to the finding and development of prospects, the preparation and presentation of business life insurance trust programs, the solution of obstacles most commonly encountered, and the nature of most effective coöperation between underwriters and trust officers.

S. S. HUEBNER

PREFACE

This book has been written to serve three groups—business men, trust officers, and life insurance underwriters—those most actively interested in the subject of the Life Insurance Trust.

Trust companies and insurance companies have recently made common cause of securing the welfare of their clients, depositors, and policyholders through the establishment of life insurance trusts. Coöperation, to be truly effective, depends upon complete understanding of mutual problems and a satisfactory agreement as to the goal to be attained. For the purpose of furthering that understanding, as well as to enlighten the business man who profits thereby, this volume has been prepared.

It deals with the Life Insurance Trust from three points of view—that of the business man and his organization; the underwriter and his problems; and the trust officer who is its final exponent. All branches of the subject have been dealt with in careful detail, so that the book can serve as a convenient source of information, and with the hope of its authors that it is legally accurate and factually complete.

The material has been grouped in parts, the subject falling naturally into five divisions Part I develops the general theory and practical workings of the Life Insurance Trust itself; its fundamental purpose of protecting the interests of the individual in making his insurance "sure." It discusses the Business Life Insurance Trust and shows that it differs only as to purpose—namely, the preservation of

stability in business organizations in spite of successive changes in ownership or management.

Part II shows how the Business Life Insurance Trust can be applied to the Sole Proprietorship and the Partnership, and how it answers the peculiar needs of these types of organization. Part III explains the use of the Business Life Insurance Trust in corporation cases and includes chapters on arrangements for insurance protection, distribution of policy proceeds, the laws on income and inheritance taxes, payment of premiums either by the corporation or by the insured individual, allowances and reimbursements for premiums paid. This division covers all possible contingencies in a corporation case.

Part IV is devoted to a consideration of the subject from the underwriter's point of view and discusses the finding and developing of prospects, the preparation of business life insurance programs to suit the individual needs of each client, points out what obstacles are to be expected in selling the insurance trust idea, and shows how these obstacles may be overcome. Finally, it suggests the ways in which trust officials and life underwriters can most effectively work together for the mutual benefit of themselves and the clients they are striving to serve.

Part V is in the nature of an appendix, including a sample work sheet for planning a business life insurance trust program, and specimen forms of business life insurance trust agreements.

Certain repetitions occur in Parts II and III. In both the Partnership chapters and those on Corporations the same points are discussed, since they apply equally to either type of organization. In compiling a useful and practical handbook, it is essential that a complete picture be given under each classification of organization, without requiring the reader to follow cross references in order to

obtain full particulars in a given case. To this end an exhaustive index has been added, so that the reader may quickly find the material for which he is searching.

Throughout the book, the use of the term "trust company" includes national and state banks with trust powers.

The authors acknowledge with gratitude the able editorial guidance of Dr. S. S. Huebner. The thanks of the authors are also due to Messrs. E. Paul Huttinger, Assistant to the Vice President, Penn Mutual Life Insurance Company, and A. Rushton Allen, Philadelphia Manager, Union Central Life Insurance Company, who have read the manuscript and have made valuable suggestions; to Mr. J. Marshall Holcombe, Jr., Director, Life Insurance Sales Research Bureau, and Mr. Julian S. Myrick, for their counsel; and to Florence C. Shepard, who has assisted in the revision of the text, proof reading, and other editorial work.

C A. S.
F. W. G.

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CHAPTER I

HOW BUSINESS IS ORGANIZED AND THE INDIVIDUAL'S PLACE IN THE NEW ORDER

It is a far cry from the lonely sheep herder on the ranges of Alberta to the President of the United States Steel Corporation at 71 Broadway, New York. Yet these men have one common interest. They are both in business. In almost every other particular they are strikingly dissimilar. The former may be said to typify the business man in the most primitive form of business enterprise; the latter, the epitome of modern business development and concentration.

The progression from one form of business to the other is an interesting study, but is not a subject with which we are now concerned. It is important, however, that we examine and explore business and the forms of organization for its conduct as we find them to-day.

Almost all the business organizations of this country fall into one of three categories: sole proprietorship, partnership, corporation.[1] The enterprising individual

[1] There are other forms of business organization such as the joint stock association, the so-called "Massachusetts trusts," which are essentially partnerships but which issue shares, the participants enjoying limited liability. These cannot be classed as either partnerships or corporations but, for the purpose of this work, may be considered as falling within the classification of corporations.

sets up shop and starts business, sometimes adopting a trade name to add dignity and prestige. After doing business successfully for some years, he invites his youthful and faithful assistant to share in the responsibilities and the prosperity of the business, and a partnership is formed. Not only does the junior member contribute his ability and probably his capital, but he makes it possible for the business to go on after the death of its founder.

The partnership later enlarges to the point where it seems advisable for the partners to incorporate, either to secure additional capital or because of the many advantages which the corporation offers, not the least of which is its continuance as an effective unit, no matter how many of the individuals who own or manage it may die or retire.

In the history of business development, the sole proprietor is the old, the original form of business enterprise; the partnership is middle-aged, and the corporation is comparatively young. In their adaptability to the complications of modern business, the sole proprietorship is rigid, the partnership is flexible and the corporation is elastic. They may be compared in their relative capacities to the pen, the typewriter and the printing press. The pen is adequate for the writing of a single letter. The typewriter can make several copies at once, and in less time than the pen. The printing press can turn out whole editions comprised of thousands of volumes.

The larger and more complex forms of business organizations do not eliminate the individual, but in most instances make him more important economically

than he would possibly be, operating as a sole proprietor. In the firm or corporation he is responsible not only for his own interests but for the interests of others as well. Usually the efficiency of each man is greatly increased by the pooling of resources, the combining of judgments; but the importance of the individual is not minimized. The special ability of each man stands out and becomes highly developed through the necessary specialization of duties as well as by reason of better and more powerful organization.

In many cases, there are several men of substantially equal value to the enterprise, each dominant in his own field, whether production, transportation, finance or sales. Many partnerships or close corporations, however, are "one-man" businesses, directed by single individuals who have grown to be the central driving force of their concerns. Obviously such men can achieve much wider success by reason of larger resources than if they were limited to their own capital and credit. While the complex forms of business may seem to absorb the individual and subordinate him to the organization as a whole, so that his identity is obscured or lost, nevertheless the result is a greater development of the inherent capacity of each worker and a marked increase in the life value of men as economic units. The more influential the individual, the greater is his life value.

With this increase in the responsibility and importance of the individual comes a new need—provision must be made for the inevitable loss of the individual in the event of death. The organization, whatever its form, must go on, even though those in charge

drop out one after another. In answer to this need, the business life insurance trust has been developed, and each year its indisputable advantages are being more widely understood. The business life insurance trust is a modern and successful financial program which applies to the three main classes of business organization above noted. Its fundamental purpose is to assure a strong and active continuance of the enterprise under successive changes in either ownership or management.

In the case of the sole proprietor, the consequences of death are plain. His business assets belong to himself alone and when he dies, barring special arrangements made by him, they will merge with his other belongings to pass to the beneficiaries he has designated in his will. The business, as a business, has no existence apart from the key life which maintains it. It cannot outlive him unless he has been careful to make explicit provision for such continuance. The sole proprietor and his business, since they are essentially one, pass off the scene together.

The partnership, under normal legal conditions, is in some ways at a greater disadvantage than the sole proprietorship in the event of death, since 100 per cent of the business may be wiped out when only 50 per cent (or even less) of the ownership dies. The death of a partner dissolves the firm. Liquidation is normal and unavoidable unless provision has been made with great care and certainty, in advance of death. Agreements for the continuance of partnerships are in effect in many firms, but the length of time which may validly be specified as the period during which the firm is to continue after the death of a partner has

never been determined by either statute or decision. When that period has expired, the survivor must wind up the business and the inevitable liquidation of the interest of the deceased partner must be faced. The business life insurance trust is particularly useful under these circumstances and is being used increasingly as its peculiar advantages are recognized.

The corporation form for the conduct of business has a position of prestige and influence in this country. In the seventeenth century, corporations opened this country and helped to originate its forms of government. One of these, the Hudson's Bay Company, still survives and does a thriving business. These colonizing corporations were widely owned by stockholders of all ranks of society. In Beard's *Rise of American Civilization* we learn that in the great London Company, incorporated to develop Virginia, there were not only earls, bishops and knights but tailors, stationers, shoemakers, grocers, ironmongers, saddlers, carpenters and representatives of many other trades, including some women. Its stock was advertised in the pulpits as well as in the market places. The London Company in Virginia, the Massachusetts Bay Company in Massachusetts, the Dutch West India Company in New York, and the Swedish West India Company in Delaware all used the great principles of coöperation and, as the author says, such a corporation went further and "exercised many of the functions of a sovereign government; it could make assessments, coin money, regulate trade, dispose of corporation property, collect taxes, manage a treasury and provide for defense. Thus every essential element long afterward found in the govern-

ment of the American state appeared in the chartered corporations that started English civilization in America."

The death of an officer or stockholder does not legally affect the corporation or its continuity. This characteristic of permanence is only one of the many advantages of the corporation. There are other reasons for the claim that the corporation form is superior to either of the other two types of organization, particularly in the case of larger units.

The principal advantages of the corporation are:

1. While a partner is liable unlimitedly as a partner and as an individual to creditors of the firm, the stockholder of the corporation is liable only to the extent of his subscription for stock.

2. The permanence of the corporation is a distinguishing advantage. As Lord Coke said in 1613, long before business corporations became numerous, "A corporation aggregate of many is not subject to the imbecilities or death of the natural body"; and John Marshall wrote two hundred years later, "By these means a perpetual succession of individuals are capable of acting for the promotion of the particular object, like one immortal being." It is to be noted in passing that the celebrated Chief Justice did not consider the individual lost in the corporation.

3. The corporation is more flexible. It can act through officers, agents and representatives. In the firm, one can never be certain that any one but a partner can act for the firm. The extent of an agent's authority is always subject to question.

4. Evidence of ownership is easily obtained, and

transfer of ownership is conveniently made. Corporate stock is probably the most acceptable form of bank collateral.

5. It enjoys the advantages of state authority and regulation. These advantages have been universally recognized in this country, by managers and investors alike, with the result that our largest enterprises are carried on in this form. It is not entirely a question of size, however, since multitudes of smaller industries are being incorporated each year.

In the fifty years between 1860 and 1910, capital engaged in manufacture increased twelvefold. By 1900, three-quarters of the manufactured products of the country were from incorporated factories. In 1927 there were thirteen corporations in the United States each owning property valued at over one billion dollars. The largest of these was a public utility company (American Telephone & Telegraph Company); there were five railroads, three life insurance companies, one steel company, one oil company and two banks.

The latest issue of "Statistics of Income" (1928 preliminary report) shows that the total number of corporations filing federal income tax returns, and their net incomes, had grown as follows, beginning with the year 1909, in which the government began to tax corporation incomes:

Year	Number of Corporations	Total Net Incomes
1909	262,490	$3,590,000,000
1920	345,595	7,902,000,000
1925	430,072	9,583,000,000
1928	473,353	9,537,000,000*

The industrial groups to which these nearly half a million corporations belong, with the number in each group, are as follows:

Agriculture and related industries	9,691
Mining and quarrying	18,074
Manufacturing	90,624
Construction	18,241
Transportation	13,087
Other public utilities	9,343
Trade	123,380
Service	35,111
Finance	140,543
Unclassified	15,259
TOTAL (1928 preliminary)	473,353 [1]

In 1929 there were formed in the state of New York, alone, 25,755 new stock corporations, as well as a large number of non-stock corporations. In other prominent states the numbers of corporations incorporated in 1929 were: 2,717 in Massachusetts, 6,359 in Illinois, and 7,375 in Delaware (a popular state for new corporations).

Of this vast and rapidly growing body of incorporated companies, there are probably only 30,000 to 40,000, or less than 10 per cent, the securities of which are held to any extent by the public. Of these only a few thousand are listed and sold on the stock exchanges of the country. The vast majority are "close corporations." Their ownership lies in the hands of a

[1] "Statistics of Income," an annual publication prepared under direction of Commissioner of Internal Revenue, contains valuable data (national and state) on individual incomes, sources of income, corporation income, and income taxes Distributed by Superintendent of Documents, Washington, D. C. Preliminary report, 5 cents; complete, 50 cents.

small group closely connected and identified with the management. It is usually vital that these few retain absolute control. The stock of such corporations has practically no public market, and provision for the transfer of ownership therefore requires careful planning. Here again the business life insurance trust provides a method to insure the preservation of that control.

At the same time that the growth in business values in this country has transpired, there has been a corresponding growth in individual wealth. The size of private estates has increased in direct proportion to the growth of big business. Side by side with this nationwide increase of wealth has come a new point of view, the tendency of a man to think of his own property as "an estate," a term formerly associated with none but persons of great wealth; an "estate mindedness" as it has been called. This trend is concerning itself with the new problems of safeguarding the business as a going concern because of the increased value to the estate thus produced.

Business life insurance properly trusteed has become indispensable in meeting this need. The business life insurance trust combines the service of the life insurance company with that of the trust company in order to protect the valuation, insure the continuity, and perpetuate the succession of business interests which otherwise are not fully safeguarded.

The complications of modern business, the varied forms of business organization and the many needs of business which life insurance meets, all unite to make it necessary that the business life insurance trust

shall be better understood by business men as well as by life underwriters and trust officers. In order that its uses may be considered in some detail, that these groups may address themselves with common understanding to a solution of their modern business problems, the following chapters undertake to deal with the subject in all its phases.

CHAPTER II

BUSINESS LIFE INSURANCE

"Business insurance" is a broad term used casually to denote any kind of insurance which serves to protect business interests. Fire insurance, marine insurance and credit insurance are property insurance against certain kinds of business risks and are the most common forms of business insurance.

What Is Business Life Insurance?

"Business life insurance," with which we are now concerned, is, as the name signifies, "life" insurance to preserve and protect those business interests of the individual which might be jeopardized by his death. It must, however, be distinguished from life insurance which the individual may carry for the immediate and direct benefit of his family. The latter is more appropriately described by the term "personal" insurance. Since it is impossible entirely to divorce the business and family affairs of an individual, business life insurance will ultimately benefit the family of the owner. For example, if a man is a member of a firm and, through insurance on his own life or the lives of his associates, maintains or increases the value of that partnership interest, his family will be the gainers; but the protection of the business asset is still the object of first accomplishment in the life insurance

program. Secondarily, the accomplishment of that object will be of untold value to the insured's family.

The motive which inspires a man to carry business insurance is usually, if not always, the ultimate protection of his family. He wishes to conserve the full value of the business interests he has created and developed, in order that that value may be passed on to his family undiminished. The business interest comes first but the persons who benefit by the insurance, secondarily but directly, are the family of the business principal, usually his wife and his children.

Reasons for Purchasing Business Life Insurance

Although business life insurance is taken out for a wide variety of purposes, these purposes fall for the most part into three groups, classified according to the use which is intended to be made of the proceeds when they become payable. These are: (1) the protection of the business against loss or interruption of earning power occasioned by the death of one of the principals; (2) the protection of the financial standing of the business at the time of the death of one of the principals, and the maintaining of confidence in the strength and stability of the business which such insurance creates in the meantime; (3) the retirement of the proprietary interest of one or more of the principals of the business (partner or stockholder) at the time of his death.

In an effort to describe them in popular terms, these classes have been called shock, credit and stock insurance. A general understanding of the different pur-

poses of business life insurance is necessary in connection with business life insurance trusts.

1. *Insurance to offset lost ability,* or to absorb in a measure the *shock* which the enterprise suffers when an important executive or employee is lost to it through death.

That there is such a loss, and that it may be very serious, needs neither argument nor illustration. Even the illness of an important executive has been known to have an adverse effect on the market value of the stock of the corporation with which he was identified. Every business community has abundant illustrations of the loss suffered by the death or indisposition of an important executive. Julius H. Barnes, President of the U. S. Chamber of Commerce, in a recent address appropriately entitled "Brains vs. Bricks," pointed out very forcefully that American business success depends more upon the ability of its executives than upon any material asset.

The business world has come to recognize that, while a sum of money cannot replace an able man, as it may replace buildings or machinery, it makes less difficult the readjustments in the business which must follow his death. Men associated together in business would, in nearly every case, agree that, if the president of the company should die unexpectedly, it would be an advantage to have a cash item of large amount, in the form of life insurance proceeds, fall due and be paid into the treasury. Often the use to which the money is to be put cannot be specified in advance, but that there are many ways in which money can be used to great advantage when the control and management

of the business are in course of change needs no emphasis or proof. Aided by the insurance proceeds, the business is able to go right on, with some inconvenience but without serious loss. Without it there might be very considerable loss or interruption of earning power.

Thus it has come to be recognized that where a business commands the services of a man of outstanding ability, the business should be compensated for the loss which it sustains at the time of his death, to the extent that this is possible. Life insurance is to-day the accepted method of accomplishing this result and very large amounts, even up into the millions, are carried upon men of preëminent position.

In cases where a number of executives shared the responsibility of a given company, the business world formerly considered insurance on their lives unnecessary. The subject is no longer dismissed without thought. The question of life insurance must be measured by estimating the difficulty which would be experienced in replacing each individual. If there would be no appreciable "shock" in case of death, life insurance for the concern may not be necessary, but if it is "worth money" to have certain men carry on for the next ten or twenty years, then they should be bonded not to leave by not living out their expectancy.

In most cases of well-officered companies it is as unwise not to insure them as it would be not to carry fire insurance on three or four widely separated factories, because "they will not all burn down at once."

This branch of business insurance has recently had strong endorsement in the ruling of the Comptroller

of the Currency, permitting any national bank to insure its officers for the benefit of the bank itself.

2. *Insurance to strengthen credit:* by providing for cash which will pay or satisfy the creditor in case of the death of that one or those upon whom he relies. It applies to sole proprietorships as well as to partnerships and corporations. It exemplifies the principle of going back of the group to the individual. The bank or other creditor may be well satisfied that the borrower will pay if he lives or that the firm or corporation will pay if the present manager lives; but what will happen if he should die? Then the business might be in sorry plight. The solution is to insure the important life; then either he or, in event of his death, the insurance company will pay the debt. Even if, as the business flourishes, the need for protection ceases to exist, the money spent for premiums is not lost. Frequently the protection is needed for only a few years, at the end of which period the cash value, whether received from the insured or the insurance company, reduces the cost of carrying the insurance to almost nothing. In individual and partnership cases, and sometimes in corporation cases, after the need for credit protection has come to an end, the policies, instead of being canceled, are taken over on fair terms as personal insurance for family protection.

An early and notable example of this form of business life insurance is that of Sir Walter Scott, who carried credit insurance in the sum of twenty-two thousand pounds. Upon his death, in 1832, the payment of this sum by the insurers helped materially in settling the last of the debts of his publishers for

which he had made himself responsible, and left his estate solvent.

A few years ago the grandson of a wealthy man had small cash resources, but was due to receive in a few years several million dollars from a testamentary trust under his grandfather's will. He established himself in the investment banking business and, after effecting full life insurance protection, had no trouble in borrowing money on the postponed bequest.

Recently a reputable close corporation in an eastern city offered its bonds to the public. The prospectus referred to the successful record of the corporation under the management of its officers, who were to continue. The bonds did not enjoy a ready sale. Life insurance to cover the value of their lives was added, and the bonds found a wide and active market.

Credit agencies and associations, and commercial and investment bankers look with favor upon and recommend this class of business insurance, although it is doubtful whether it has been developed to its full usefulness. It has not yet been extended to the protection of regular lines of commercial credit, such as large open accounts, to any appreciable degree. It is of special importance on the lives of partners, officers or even stockholders who are influential in securing credit.

3. *Insurance to provide for transfer of ownership.* This form is sometimes used for sole proprietors, more often for partners, and still more frequently to provide for the sale and purchase of the stock of a fellow stockholder in a close corporation.

Through this sort of insurance the sole proprietor

may arrange for the carrying on of his business after his death, and even for its incorporation. However, business life insurance in the case of sole proprietorship may be considered generally as private or personal insurance, unless the proprietor has arranged some plan to transfer the business to one or more employees after his death. (See Part II, Chapter V, *infra.*) A judicious practice for men carrying on their enterprises as individuals is to provide in their wills for the reorganization and carrying on of the business in corporate form after their deaths.[1]

More often, however, the sole proprietor through indifference or carelessness omits to plan for the disposal of the business after he is taken away. Instead, he centers his thought upon his family in the belief that they will be adequately provided for in the sale or distribution of the business assets. If under these circumstances the sole proprietor carries any insurance, it is in effect personal life insurance.

Each partner may arrange, by means of insurance, for a settlement of his interest at death, and correspondingly may also arrange that if he is one of the survivors he may acquire the interest or part of the interest of any other partner who dies. This is being done with greater frequency and it can be carried out most satisfactorily through the business life insurance trust. The family of the deceased partner are not particularly interested in the future of the business but wish to get as much as possible through the normal

[1] Several recent cases where clumsy and unsuccessful attempts have been made to accomplish this result emphasize the urgency of having a carefully thought out and well-drawn will.

partnership method of settlement, liquidation, as soon as it can be made available to them. Foresight will provide a surer, an earlier, and in all likelihood a much larger settlement for them through the use of business life insurance properly planned.

Business Failures in 1929

No individual, firm or corporation anticipates business failure or insolvency. The possibility of financial adversity in their own case seems more than remote. However, even a cursory glance at statistics on business failures will convince even the most skeptical that on the law of average, failure is not entirely out of the question.

In the year 1929 (*Bradstreet's Failure Statistics for 1929*) business failures in the United States totaled 19,703, with liabilities of $628,047,146. (It is fair to take 1929 as an example, because, in spite of market conditions in the fall of that year, failures as a whole were slightly below those of the three preceding years.)

Covering a wider period, it is significant to note that in the nine years 1921-1929 the total number of business failures is larger than the gain (over the same time) in the total number of individuals, firms and corporations engaged in business. In other words, failures actually exceeded the number of new businesses which were started during that period.

Bradstreet's gives the following as its definition of a business failure: ". . . it must involve some loss to creditors of individuals, firms or corporations engaged in ordinary commercial operation." Any failures

to succeed, which do not involve loss to creditors, are not included in *Bradstreet's* data. For this reason, in their total of 19,703 failures in 1929, failures of professional men, physicians, lawyers, etc., as well as of stockbrokers and real estate men are not included. The total of 19,703 is therefore a conservative and incomplete figure for failures in general.

Of all the causes to which failures in 1929 are attributed, *lack of capital* claimed the largest proportion, or 37.2 per cent of all failures. *Incompetence* is next with 31.4 per cent, and *specific conditions* such as war, disaster and floods were responsible for 15.6 per cent.

"In discussing factors making for success in most human undertakings, business or otherwise, stress has always been laid upon the importance of the personal element. From this, in turn, has come a variety of proverbs conveying the idea that upon the individual rests, and, in the last analysis, has always rested, the responsibility for success or failure in any or all undertakings." [1]

To sum up the obvious conclusions to be drawn from the above data:

1. Lack of available capital, the outstanding cause of business failure, can be guarded against to some extent by carrying sufficient insurance to liquidate interests of deceased partners or stockholders.

2. Life insurance, properly trusteed, can be guarded from creditors in case of failure.

3. In view of the importance of the individual in

[1] *Bradstreet's Failure Statistics for 1929*, "A Record—not a Prospectus," p. 4 (The Bradstreet Company, 1930).

determining business success or failure, it is vital to have the life values of outstanding members in any firm protected by adequate insurance.

The Close Corporation

There are two reasons why insurance in the close corporation is important: (1) it is desirable to keep it a "close" corporation, and (2) there is no general market for the stock. In the case of the close corporation, it is most advantageous to keep the interest of the decedent stockholder within the group who are active in the business. Here also a sale in the best interests of his family can be effected through the use of business life insurance equal to the whole or a substantial portion of the value of his stock.

There is a material difference between the interest which a deceased partner leaves at his death and that of the stockholder in a corporation. In the former case the firm must pay off or settle in some other way the interest of the decedent partner, or else submit to the normal process of liquidation and start all over again. The estate or beneficiaries of the decedent partner have normally no interest in the future of the business after his death.

In the corporation case, however, the interest of the deceased stockholder after his death is represented by the stock which he leaves. There is no question of the liquidation of the enterprise unless serious complications follow his death, making it necessary to wind up the corporation. The problem in this case, if ownership is to remain among those active in the management, is to provide for the sale and purchase of the

stock left in the estate of the decedent. The necessity of having the business in such shape that when one of the stockholders dies it may continue without reduction or change in the details of its operations is a factor of no small importance in showing the value of business life insurance.

Generally speaking, the partner may be said to leave behind him an interest in the assets, and the stockholder an interest in the business.

Just as personal insurance is usually needed for several purposes, so in the case of business life insurance any or all three of the reasons outlined above—shock, credit, and stock—call for life insurance protection for the firm or corporation. Sometimes the insured himself is least qualified to express an opinion or decide as to the suitability of business life insurance and the need for the protection which it affords. In another recent case, for example, after the president of a close corporation had decided that there was no need for business insurance on his life, the underwriter politely insisted upon an interview with the Board of Directors on the theory that they, rather than the president, should decide on his value to the corporation. The result was that the Board of Directors voted unanimously that a substantial amount was needed and should be taken out upon the life of the president for all three purposes: namely, to cover the general shock which the corporation would sustain in case of his sudden death; to cover the probability that the bank from which they borrowed on a regular line of credit negotiated by the president would, upon his sudden death, demand a reduction in the outstanding

notes; and, most important of all, to provide an amount which should be used to purchase from his wife and sole heir enough stock to place the surviving associates in control of the enterprise. Both the president and his wife had long felt that she did not wish to be left as the controlling stockholder. This case also illustrates the fact that it is sometimes desirable to readjust stockholdings rather than retire them altogether, upon the death of a prominent stockholder in a close corporation. Such readjustments should be planned in advance with special care.

An unusual situation exists in the case of partnerships or close corporations carrying on a financial business such as investment banking. Owners of this type of business are apt to think that they are not under the same necessity to provide cash through insurance for the settlement of the affairs of decedent members, because the securities in which they deal may be used in effecting such settlements. This attitude fails to take into consideration the changes which have occurred in investment banking during the last ten or fifteen years. While partnerships and corporations engaged in investment banking do have assets more readily converted into cash than dealers in furniture or canned goods, for example, there is no question but that the proper settlement of the estate of one having an interest in such business calls for much ready cash, and this is best provided through life insurance. In a recent case, a business life insurance program covering the $600,000 capital contribution of one partner was arranged. Within three months after this partner died, the liquidation of his interest was quickly and satisfactorily accomplished, and the business was

continued by the surviving partners under a new partnership agreement.

In still another case, a financial house carried $100,000 on the life of each partner as shock insurance. After the upheaval in the stock market in October, 1929, they wisely applied for $100,000 each additional life insurance to strengthen their credit until the book value of their securities had been restored. There is no class of prospects for business life insurance with potentialities for development so great as firms and corporations engaged in the business of investment banking and brokerage.

While, therefore, it may be important to have life insurance protection for only one of the main purposes above given, it may be as vital to have it for two or three purposes in greater or less degree. The proper interrelation between these different forms of business insurance is not difficult to achieve, though it may take time and necessitates careful consideration of the whole situation on the part of the underwriter. The life underwriter and the trust officer, out of their experience, must be able to present plans for the future of the particular business as it will be affected by the death of its principal owner or owners. They must emphasize the fact that death almost always occurs at an unexpected and inconvenient time, and they must show how the business life insurance trust may then be of the greatest assistance to the business, to the surviving associates and to the family of the deceased associate. When the needs have been studied and the life insurance protection planned, the business life insurance trust is used to make certain that the purpose for which the insurance is carried is fully realized.

CHAPTER III

THE LIFE INSURANCE TRUST

The Beginning and Growth of Life Insurance Trusts

The first life insurance trust of which there is record was established in 1869, with the Girard Trust Company of Philadelphia (then the Girard Life Insurance, Annuity and Trust Company of Philadelphia) as trustee, and as one of the beneficiaries of this trust is alive, the trust is still in effect. The administration of life insurance proceeds by trust companies as trustees did not come into common use until after 1920, however. Its rapid growth and almost universal acceptance by the general public proves its value and usefulness.

The life insurance trust is a combination of life insurance and trusteeship, which enables the policyholder to arrange for the investment and distribution of the policy proceeds with the utmost effectiveness and with the widest possible latitude. In effect, the holder of the policies delivers them to his trust company as trustee and says, "I want you to see that the money from these policies is used for such and such purpose at such and such time," and the trust company undertakes this duty.

There is no subtlety in the name, "Life Insurance Trust," or in the plan itself. It is not a bewildering labyrinth of technicalities designed for tax evasion or

with secret advantages for the insurance agent and the trustee. It is a simple, direct arrangement expressed in an instrument called "A Deed of Trust," or "A Trust Agreement," which contains provisions governing the delivery of the policies to the trustee, and outlines the duty of the trustee in the investment and distribution of the funds in its hands.

The life insurance trust for the benefit of the family and dependents of the insured is perhaps the most widely known and the most generally understood. This may take one of two forms: (1) the unfunded trust, or (2) the funded trust.

The Unfunded Trust

In the unfunded trust the holder of the policies in delivering them to the trustee provides that upon his death the trust company is to collect the proceeds of the policies from the insurance companies. It is then to invest this sum and to pay the income from the investments to the wife and children of the insured (or to any other persons whom he may choose to designate).

The unfunded insurance trust has many advantages to the policyholder:

1. It prevents the dissipation of the proceeds of the policies which might otherwise be payable in a lump sum to the beneficiary.

2. It provides a single uniform plan for handling the proceeds from policies of several different companies.

3. It is a flexible method of providing for possible emergencies.

4. Every trust fund is administered as a separate unit with the securities and assets earmarked and kept apart from the other assets of the trust company and from the assets of other trust estates. It receives individual attention in matters of investment.

5. Life insurance deposited under the terms of a properly drawn trust agreement makes cash immediately available to the executor of the insured's estate for the payment of inheritance and other taxes.

The Funded Trust

The funded trust is similar in form to the unfunded trust, but in addition to the deposit of life insurance policies with the trustee, the policyholder also deposits securities, the income from which is collected and used by the trustee for the payment of the premiums on the life insurance policies.

This form of trust also has several advantages:

1. It is the most economical method by which the insured can create the maximum estate at a minimum cost.

2. It prevents lapse of the insurance policies for nonpayment of premiums.

3. It relieves the insured from the tedium and burden of making numerous premium payments.

Increase in Amount of Life Insurance in Force and in Amount Put in Trust

The rate of growth of life insurance in this country during the last twenty years has been nothing short of phenomenal. In July, 1929, the total amount of insurance in force in the United States was more than

one hundred billion dollars. The increase in the size of estates administered by the banks and trust companies of the United States as trustees has been equally impressive. Of late, the rate of increase in the use of the life insurance trust has focused attention upon this relatively new form of protection. According to surveys conducted by the Trust Company Division of the American Bankers Association, the amount of insurance policies in the United States deposited with banks and trust companies as trustees in the year 1927 was \$250,000,000; in 1928, \$700,000,000; and in 1929, \$1,200,000,000. In other words, of the \$100,000,000,000 of life insurance now in force, more than 2 per cent is already deposited with the banks and trust companies of the United States as trustees under insurance trust agreements. The increase in the total amount of life insurance in force, and in the amount of insurance policies deposited with the banks and trust companies as trustees under life insurance trust agreements, has been the result of splendid coöperation on the part of the life underwriters and the trust officers of the country. Since 1920 the life insurance trust has been the most significant development in the fields of life insurance and trust service. To-day the subject needs no introduction to either life underwriter or trust officer. The face amount of insurance policies already deposited with the banks and trust companies of the United States as trustee under life insurance trust agreements (\$2,500,000,000) is convincing evidence of the tangible results of the coöperative movement.

The importance of coöperation on a sound basis has led to the adoption of joint statements of general prin-

ciples of coöperation by committees representing national or local associations of life underwriters and corporate fiduciaries. The first of these statements was adopted by the National Association of Life Underwriters, and the Trust Company Division of the American Bankers Association in April, 1928, and read as follows:

> We appreciate the widespread and able coöperation which exists between life underwriters and trust officers in creating life insurance trusts, and express our belief that the services of well-equipped men on both sides of this great development are necessary, in order to properly occupy the unlimited field.
>
> We urge our members to measure up to the highest standard of this coöperative effort and to appreciate the remarkable assistance which trust companies and banks (life insurance companies and life underwriters) are giving to us.
>
> We believe that successful coöperation requires that each factor serve in its own field, help the other without compensation or competition, and thus promote the best service without friction or danger of diverting business from those who originate it.

Numerous other statements, both of principles and of practice, have been adopted by local associations of life underwriters and corporate fiduciaries in many cities of the country, and local coöperating committees exist in several large cities.

In addition to this activity, joint meetings of the two bodies have been held in many places, addressed by leading authorities from the two groups. In many cities, series of such meetings known as "Life Trust Round Tables" have done much to cement the com-

mon interest and further the common cause. Personal acquaintance and mutual understanding replace former unfamiliarity. In some cities insurance trust round tables or councils function permanently.

The trust companies have aided the sale of life insurance immeasurably during the last five years. Newspapers have been full of advertising prepared and paid for by the trust companies, endorsing life insurance and stressing the values of the life insurance trust. Attractive and handsomely illustrated booklets and other advertising material on the subject have been distributed gratis by the trust companies to life underwriters and to the general public. Courses of lectures designed especially to aid life underwriters have been conducted without expense to the listeners. There is much material, written and printed, in the hands of the trust companies that can be used by the life underwriter to great advantage, and no underwriter should consider himself fully qualified and experienced until he has established an intimate contact with an important trust company, and has mastered the presentation of the life insurance trust as it is recommended by that institution.

The presidents of six of the leading banks and trust companies of Boston, at the instance of George W. Smith, President of the New England Mutual Life Insurance Company, issued an endorsement of business life insurance, particularly for the purpose of retiring the interest of a deceased partner or stockholder in the concern, as follows:

> Life insurance offers an effective and certain method of retiring the interests of a deceased partner or stockholder

without disturbing the continuity of a business. It has four outstanding factors of value: First, nominal cost, amounting usually to less than 3 per cent annually of the principal to be retired; second, guaranty of the payment of the capital fund without delay; third, exemption from Federal Income Taxes; fourth, absolute security. These associated factors make Business Life Insurance not only a sensible business procedure but an essential protection.

The Business Life Insurance Trust

The latest phase of coöperation between life underwriter and trust officer, and, many believe, the most important field for the development of the life insurance and the trust business, is the business life insurance trust. The business life insurance trust is a new form of the life insurance trust, a useful and important extension of life insurance to business needs and the adaptation of the services of the trust company to the prompt and advantageous application of the insurance proceeds to certain business purposes, as will be explained later.

It has the same advantages as those possessed by life insurance trusts created for the personal benefit of the insured and his beneficiaries. It differs only in that it is designed primarily for the protection of business interests, particularly for the retirement of the interest of a partner or of a stockholder in a close corporation at the time of his death.

The business life insurance trust may take the funded or the unfunded form. It may cover policies on several lives in a number of life insurance companies. It may call for the exercise of discretion on the part of the trustee. It may be used to simplify and expedite

the payment of the insurance premiums by the trustee.

It is an added form of insurance protection for business interests, conveniently administered by a modern institution, the trust company, as trustee.

CHAPTER IV

BUSINESS LIFE INSURANCE TRUSTS AND THE TRUSTEE

While the protection of business interests through the use of life insurance, for the purposes explained in Chapter II, is an established practice and easily comprehended, the business life insurance trust, being of more recent origin, is less generally understood. That the purposes of business life insurance are best served by the creation of a business life insurance trust is accepted, but the reasons for it are not so well known. The part played by the trust company as trustee, the cases in which a trustee is absolutely indispensable, the cases in which a trustee is not necessary but advisable, and the cases in which the interests of the parties can be as well or better served without a trustee will bear study and analysis.

The Duties of the Trustee

Before proceeding to a more detailed consideration of the three main purposes of business life insurance and the part played by the trustee with relation to their fulfillment, let us first clearly understand what the duties of the trustee in general are or may be. *A business life insurance trust consists of a program of life insurance whereby the proceeds of certain policies of insurance on the life or lives of one or more of the principals are payable to a bank or trust company as*

trustee, such proceeds to be collected and disbursed by the trustee in accordance with the terms of a written agreement between the parties concerned and the trustee.

1. *To Prevent Lapse of Policies.*—It is well to remember that in almost all cases there is an interval of time, sometimes of many years' duration, between the taking out of the insurance and the maturity of the policies, during which time premiums must be paid, the policies kept alive, and other matters of routine attended to. If the insurance is permitted to lapse, the whole program will fail. Therefore, whether the services of a trustee in the disbursement of the policy proceeds are necessary or not, as we shall later determine from an analysis of different cases, it is almost always advisable to name a trust company as trustee for the routine work of the business insurance program.

2. *To Pay Premiums When Due.*—The most important function in this routine work is the payment of premiums on the life insurance policies when due. If there were only one policy on an annual premium basis, the work would be simple; but the ordinary case involves several policies on different lives in different companies and the money for premium payments comes from several sources. It is obvious that the premiums cannot be paid unless some one furnishes the money for such payment and some one must also collect the money from those who have obligated themselves to furnish it. There is no reason why this work of collecting cannot be done by one of the partners or stockholders, or by a clerk in the office of the firm or corporation; but it is usually quite foreign to the

duties of the individual who undertakes it. It is therefore an added burden, and not infrequently it is slighted or overlooked with unfortunate consequences of no small moment. No matter for what purpose the insurance may be taken out, the appointment of a trustee to handle premium payments and the other routine business of the trust is an advantage, particularly if the trustee is a trust company which includes just such matters in the sphere of its daily operations. Where the premiums are made up of joint contributions from several persons, and where the insurance consists of policies on different lives in several companies, the trust company trustee is quite impersonal and insistent in calling for prompt contributions to the premium fund and equally punctilious in remitting the premiums to the different insurance companies when due. While a business life insurance program for a limited number of purposes, about to be discussed, can be carried on without the services of a trustee, the use of a trust company in nearly all cases is a convenience and an assurance of thorough attention to the necessary details without which no business insurance trust can be successful. The charges are not high, as will be pointed out at the end of this chapter.

Cases in Which a Trustee Is Not Required

If the parties have decided that they themselves can handle the routine work connected with the business insurance program, the next question to be determined is: "Is it necessary to have a trustee to collect and distribute the money from the policies when they mature?" *When the only object to be accomplished is the*

protection of the business against loss or interruption of earning power occasioned by the death of one of the principals or the protection of the financial standing of the business at the time of the death of one of the principals, or both, there is, in most cases, no need to have the policy proceeds paid to a trustee and, save for the routine work above mentioned, the insurance program can be handled direct by the parties in interest. This is not a universal rule, however. There are a few cases of shock and credit insurance in which the services of a trustee are valuable. The situation which will exist when the policy becomes a claim may be radically different from the conditions which prevailed when the insurance was issued. If it is deemed advisable to make certain that the insurance proceeds will be used to greatest advantage, the trustee may be a valuable if not indispensable part of the insurance program.

Cases in Which a Trustee Is Essential

In cases where the retirement and liquidation of the interest of one of the principals is sought, the services of a trustee are most important. Let us now consider the functions of the trustee in such cases and the part played by the trustee in the handling and distribution of the policy proceeds when the policies have matured.

Probably there is no more effective way to emphasize the value of the trustee in such cases than to consider the effectiveness and safety of having the insurance paid over to and handled by some one not a trustee under a regular trust agreement. Let us assume for the moment that four persons, either mem-

bers of a firm or stockholders in a close corporation, wish to provide business life insurance for the purpose of buying out or retiring the interest of one another in the business whenever the death of one of them occurs. There are three possible methods of disbursing the insurance proceeds when the policies mature through the death of the insured: (1) the insurance on the life of each may be paid to the executor of his estate, (2) the insurance on the life of each may be paid to one or more of the survivors, or (3) the insurance may be collected and distributed by the insurance company under a prearranged schedule of payments, fixed in advance as to both time and amount.

For the retirement and liquidation of the proprietary interest of the deceased in the business none of the three methods of payment proposed is wholly satisfactory. If the insurance on the life of one of the principals is made payable to the executor of his estate, it does not help the survivors to retire the interest of the deceased except in so far as it places the estate of the deceased in an easier cash position and puts his family in funds for living expenses, thus making the actual retirement of his interest less urgent than would otherwise be the case. This, however, is not much help to the survivors. If A owes B $100,000, payable immediately, the fact that B has plenty of money permits A to interpret "immediately" not quite so literally as if B's executor is without funds and B's family is in urgent need of money for bread and butter. It does not reduce the indebtedness one penny below $100,000 nor does it put A in funds with which to pay it.

Disadvantages of Paying Proceeds to Surviving Partners or Stockholders

The payment of the funds to one or more of the survivors will not prove to be more satisfactory. It is impossible to determine accurately or even to estimate what the value of the proprietary interest of the deceased will be at the time of his death. If at the time the insurance is applied for, A's proprietary interest is worth $100,000 and he survives ten years, his proprietary interest at the time of his death may be worth five times or ten times or twenty times, or one-half of that amount. The person who is to acquire and pay for that interest should not be the one to fix, on behalf of the deceased, the value of that interest. If he is unprincipled, he will state a figure below its real worth. If he is overconscientious and inclined to generosity, he will feel that in order to avoid criticism he must fix an amount considerably above the real value of the interest, and thus fearing criticism will do himself an injustice. No man wants to have his family subject to such risk nor to put one of his associates in a position of such embarrassment. A business man's family always believes his business interests are worth more than their true value, and the price fixed for them under such conditions is always thought to be inadequate. No surviving business associate, whose judgment and opinion must unavoidably be colored by considerations either of self-interest or generosity, should be selected to put a fair price on something he is about to buy because the price he fixes is sure to be unfair to the estate of the insured or to himself.

Proceeds Handled by Insurance Company

In cases where business life insurance has been purchased to retire the proprietary interest of the deceased, it is utterly impractical to have the insurance proceeds held and distributed by the insurance company. Even the companies with the most liberal powers under their charters will not undertake to distribute funds except in accordance with a definite schedule, agreed upon at the time the insurance is applied for, specifying the beneficiaries, the dates of payments and the amounts (subject to variation to the extent that the earnings of the insurance company permit an increase above the rate guaranteed by the company at the time the policy is issued). No company will undertake to make any payment in an amount to be ascertained, arrived at or influenced by the judgment or opinion of any one outside the insurance company itself. The insurance company is in the business of insuring lives, not in the business of liquidating business interests, and properly considers its functions to be that of reimbursing some one somehow for the loss sustained. It is not its business to ascertain who should be reimbursed, when they should be reimbursed and how much they should be paid. That is quite outside the scope and sphere of activity for which the insurance companies were formed and exist to-day.

It will thus be seen *that none of the other possible methods for liquidating the proprietary business interest of a deceased principal in a firm or corporation is satisfactory and that the services of a trustee are indispensable.* Let us now consider the subject in some-

what greater detail with relation to the three main classes of business organization.

Sole Proprietorship

Business insurance in the case of sole proprietorships is, in effect, private insurance in many cases, as pointed out in more detail in Part II, Chapter V, *and when this is true there are very few cases in which the creation of a business insurance trust with life insurance policies deposited under a trust agreement is advisable. In fact it is usually inadvisable.* In sole proprietorships, business insurance is carried to protect the business against loss or interruption of earning power occasioned by the death of the owner or to protect the financial standing of the business at the time of the owner's death. Necessary arrangements should be made to reimburse the business interests of the deceased for loss of earning power occasioned by his death, and to keep the business in liquid cash position, ready to meet the claims of all creditors. This can best be accomplished by carrying life insurance in sufficient amount. The administration of these funds may be confided to the trustee of an insurance trust or the executor of the insured under the terms of a carefully thought out and well-drawn will. In states where the state inheritance tax rate is in excess of the rate of the Federal estate tax, the former method is preferable. (See Part II, Chapter V, page 70.)

Partnership

In the case of a partnership, *where insurance on the life or lives of one or more partners is carried to offset*

the loss of earning power of the firm and the lessened prosperity of the business occasioned by the death of a partner, the policies may be payable direct to the surviving partners or to the firm. There is usually nothing to be gained in having them paid to and administered by a trustee.

If the purpose for which the insurance is carried is to fortify the cash position of the firm and to sustain its credit standing, or to accomplish this result along with the reimbursement for loss of earning power, payment may likewise be made direct, in most instances, to the firm or to the surviving partners. In a few cases, creditors will demand special protection for credit extended. They may insist that, before they advance money or extend credit to the business, life insurance be carried on one of the partners to the amount of the debt, and in case of the death of the insured, they will not consent to the insurance money being paid to the firm. Their attitude is based on the fact that the insurance proceeds would not be available for the payment of their debt without also being open to the claims of all other creditors as well. To have the policies payable direct to the creditor is unsafe, for at the time of the maturity of the policies the indebtedness might have been extinguished or reduced.

Nor will the creditor be satisfied to have the money paid direct to the firm or to the surviving partners, for the firm or the partners individually might decide to use the money for some other purpose than the liquidation of that particular creditor's claim. None of these objections apply, however, when the money

is paid to a trustee. The agreement should provide that the trustee is not to pay over the money until satisfied as to the amount and the validity of the creditor's claim, and that the trustee is not to use or permit the use of the funds for any other purpose whatever until the claim of the creditor has been liquidated or withdrawn.

The only possible disadvantage in such an arrangement is that in the event of insolvency or bankruptcy of the firm, any premium payments on the policies made within four months of bankruptcy might constitute a preference and would be voidable. (*11 U. S. C. A. Sec. 96*[*a*].)

In all cases in which the retirement and liquidation of a partner's interests is involved, whether that is the only purpose of the insurance or one of several purposes, the creation of a business insurance trust and the intervention of a trustee are indispensable. The situation calls for an impartial stakeholder, one who will, first of all, collect the money from the policies, who will then take steps to have the value of the proprietary interest of the deceased partner in the firm ascertained, and who will finally apply the funds in his hands for the retirement of that interest. Regardless of the size of the firm and the importance or insignificance of the partnership interest involved, there is no agency in which are combined the stability and impartiality of the corporate trustee so indispensable to the success of that kind of business life insurance program. Certainly no other method of distribution affords the security, the certainty and the facility to be found in the trust.

The Corporation

In cases of business life insurance for the corporation, where the insurance is primarily to compensate for the loss sustained in the death of the principal, the payment may just as well be made direct to the corporation.

Where the strengthening of the general credit position of the corporation is desired, there is nothing gained in having the money paid to a trustee. In a very few cases where individual creditors demand special insurance protection for their claims, the services of a trustee may be used to advantage. Sometimes there is a specific item of indebtedness which hangs over the corporation, such as a mortgage on its property. In other cases, large advances may have been made by an individual creditor to enable the corporation to start business, where the principal reliance of payment rests on the initiative and ability of the corporation head. If he should die, the creditor would want the corporation's debt to him to be paid immediately and would not care to leave his money in a business which was to be run by an understudy.

In still other cases, the interested parties may wish to include a trustee in the administration of the proceeds, if they do not have full confidence that the survivors will possess the good judgment to apply the money from the insurance policies to the best advantage of the corporation. For example, there was a recent case where fifty thousand dollars worth of life insurance was taken on the life of the president to protect the credit of the corporation. It enabled the

corporation to borrow more liberally from the banks. The understanding was that the money would be used to pay off bank borrowings in whole or in part, but the young men who succeeded to the business, with the best of intentions and with the consent of practically all the stockholders, decided that it was much better to use this money for expansion. It would have been more nearly in accord with the wishes of the insured, who was the principal owner, if the proceeds had been bound by agreement to be used for the purpose he had intended when the life insurance was written.

Except for cases of special nature, however, the money from the insurance policies should be paid direct to the corporation when those interested, whether as officers, directors or stockholders, unite in a business insurance trust program for the sole purpose of strengthening the credit position of the corporation.

When the program seeks to accomplish one of two other objects, namely, (1) to reimburse the officers, individually for the pecuniary loss they have sustained in the death of the insured, or (2) to place the surviving officers in funds which they can use to strengthen the credit position of the corporation, either by buying new stock or by taking up and holding, as individuals, notes and other obligations of the corporation outstanding in the hands of outside creditors, the funds may be paid direct to the fellow officers of the insured.

Fellow stockholders of the insured are rarely made direct beneficiaries of the policies, except where an unusual situation is to be met. For example, if an indi-

vidual stockholder has some special pecuniary interest in the life of one of the officers of the corporation, the policy proceeds are sometimes paid direct to the interested individual. These cases, however, are exceptional and rare. Where the policies are intended to fortify the credit position of the corporation, they are made payable to the corporation direct, as pointed out above.

Cases Where Business Life Insurance Trust Is Indispensable

Where the insurance is intended for the retirement and liquidation of the interest of a deceased stockholder, the business life insurance trust is indispensable.

At the time of the death of the insured, when his stock interest in the corporation is to be liquidated and retired, there is no agency which can function so effectively and so satisfactorily to all parties concerned as the trustee. Here again, as in the case of a partnership, the trustee collects the insurance money, takes steps to have ascertained the liquidating value of the shares of the deceased stockholder, and pays over the sum due therefor or as much thereof as it may have available upon the relinquishment or release of the deceased stockholder's interest. Of course, the duties of the trustee in the case of either partnership or corporation are fully prescribed in any properly drawn trust agreement, and the trustee must see that the interest of the deceased passes, in the right proportions, to the survivors or whoever may be entitled to receive it.

Why a Trust Company

A trust company (and this term when used throughout the book is intended to include banks with trust powers) should always be selected as the trustee of a business life insurance trust. Whatever may be said for the appointment of an individual trustee under wills, *no business insurance trust should be set up without a trust company as trustee.* First of all, these institutions are well equipped to handle the business, as the administration of trusts is within the sphere and scope of their daily activities. The ample capital and resources of modern trust companies are full guarantee of faithful performance of duty. Organization and management assure that the business will be handled with impartial judgment and a high degree of intelligence. The considered finding of a trust company in the administration of one of its trusts has a prestige which is perhaps not equal to but is comparable to that of a court of law.

The payment of premiums when due, and the collection of the necessary funds to make such payments should be the function of some one who is accustomed to this kind of work as part of his regular business duties. It should not be an added burden of detail to the secretary or treasurer of the corporation whose time is already sufficiently occupied with other matters. Where the parties in interest are numerous, and the payments into the fund are frequent and are apt to be irregular, the bookkeeping incidental to the management of the business life insurance, particularly where there are several policies in several companies,

is very tedious. In addition, it is well to have the calls for premium payments come from an outside agency instead of from an intimate business associate in the same office.

A trust company is ideally suited to collect the policy proceeds and hold them until time for disbursement. A trust company does not die. It is never ill nor absent on vacation. Its only interest in administering the trust is to carry out the terms of the trust agreement. It has no favorites to humor, no enemies against whom to retaliate.

There are times when the appointment of one or more individual co-trustees to serve with the trust company is desirable. An individual who is on intimate terms with all the parties to the agreement and in whom they have confidence may facilitate the working out of the agreement. Unless, however, the parties in interest earnestly desire the appointment of an individual co-trustee, it is much simpler for the trust company to be able to act without having to consult any one else and the trust is just as faithfully performed by the trust company as if its every act were scrutinized and criticized by an individual co-trustee. There should never be more than one individual co-trustee, for if there is more than one, the work of the trust is apt to become complicated and involved. One or another of the individual trustees is sure to be ill, absent or out of reach when important papers, requiring the joint and concerted action of all the trustees, are to be signed.

Fees for Trust Services

There can be no fixed charge for the services of the trustee because the duties of the trustee may vary in each case. For all practical purposes, the following schedule of fees for business life insurance trusts, adopted by the Corporate Fiduciaries Association of New York City, will serve as a guide to charges ordinarily made in such cases. The schedule is as follows:

1½ per cent on the amount of insurance collected up to $50,000
1 per cent on the next $200,000
¾ of 1 per cent on the next $250,000
½ of 1 per cent on all amounts over $500,000

In addition to the above, where stock is deposited, the annual fee on the par value thereof shall be charged at the following rates:

1/20 of 1 per cent per annum on par value up to $100,000
1/50 of 1 per cent per annum on par value from $100,000 to $500,000
1/100 of 1 per cent per annum on par value on all over $500,000.

Stocks of no par value are taken at $100 par value.

PART II

SOLE PROPRIETORSHIP AND PARTNERSHIP

CHAPTER V

SOLE PROPRIETORSHIP

Economics

In the days before mass production and concentration of capital, the sole proprietor was the most important factor in the business world, both in numbers and with respect to resources. Partnerships were not uncommon and in a number of instances were influential and important in their operations. Communication was difficult, travel was slow, and, with the sphere of activity thus confined to narrow limits, the business of the day was transacted by the individual traders or sole proprietors. A special Act of Parliament or of the state legislature authorizing the establishment of a particular corporation was necessary in each case and the number of corporations was necessarily very small. With the increase of capital, the improvement in means of travel and communication, and the organization of business into large units of production and distribution, a change has taken place. The numbers of sole proprietors have dwindled and the corporation or partnership form of organization is much more common. Where formerly 10,000 grocerymen or druggists kept their corner establishments, to-day one corporation with 10,000 stores stretching from coast to coast sells standard brands at uniform prices. The small trader is

being driven from business. With limited resources, he cannot compete with the concentrated buying power and low sales cost of the larger organization. Few men go into business for themselves to-day. Instead, they form a partnership and pool their capital with one or two others, or buy an interest in a business by acquiring a substantial stock interest in a corporation. Where a person of large means has sufficient funds to enable him to make an investment in one or more business enterprises, he does not do this by himself engaging directly in the different businesses. He forms one corporation to conduct one business, another to conduct another, and so on. He may permit others to run a business for him by providing the capital for a limited partnership, of which he will be a special partner.

For certain kinds of business, the partnership, either general or limited, is the most popular form of organization. Membership in stock and other exchanges is frequently limited to individuals and members of firms, corporations being ineligible. For professions such as law, architecture, advertising and engineering, requiring little or no capital but depending for their success on the individual initiative and ability of the principals, the partnership is entirely satisfactory.

There are not as many sole proprietorships to-day as formerly. In many instances the individual owner has incorporated his business and has given a little stock to people in the office, or he has admitted a valued assistant as a junior partner with a small share in the profits. These are not cases of sole proprietorship at all. On the contrary, they are precisely the kind of corporation and partnership enterprises which the

business life insurance trust was designed to serve. Both partnership and corporation cases are fully dealt with in succeeding chapters.

There are, to be sure, some sole proprietors left, and in the protection of their business interests life insurance plays an important part. Jobbing, retail stores, specialty and novelty businesses are often found to belong to one man. An eminent lawyer or doctor sometimes maintains his practice single-handed. Life insurance meets a definite need in all these cases. The business interests of these individuals should be protected, and business life insurance should be used to cover the investment worth of their respective enterprises.

Many business men draw a sharp line of demarcation between business interests and private investment. Sole proprietors to-day should run their business matters separately, and quite apart from their personal affairs. They ought to keep separate books, have a drawing account, or pay themselves a salary, and build up their estates either by ploughing surplus earnings back into the business or by withdrawing such surplus from the business, from time to time, and investing it as part of their private fortunes. Thus a man can tell whether his business is earning a proper return on the amount of capital invested in it or whether it is a mere extravagance.

To such men, life insurance has a twofold appeal and should be made to apply to the two spheres of activity. It may protect the insured's capital investment in his business and this we may call his "business insurance"; or it may protect his life value for the members of his family and this we may call his "personal

insurance." He should have enough insurance for both purposes, for, although the two are interrelated, they are not identical.

Putting aside all consideration of the insurance which he carries for the purpose of protecting his family, let us concern ourselves only with the insurance which he carries for the protection of his business. The natural and orderly thing for him to do is to carry enough insurance so that the business will be liquid at the time of his death. This is important, whether the business is to continue or is to be wound up. If it is to continue, there must be adequate working capital to maintain the confidence of customers and creditors after the motive power of the proprietor has ceased. If it is to be liquidated, it is worth more as an active concern than its assets will bring under the hammer or at private sale. A business in liquid cash position will always fetch a better price than one composed entirely of real estate, raw material and inventory.

There are few sole proprietors who carry sufficient business life insurance and of those who do, there are fewer still who make full and careful provision for the use of the life insurance money to best advantage. In firms and corporations, the surviving partners, officers or fellow stockholders of the insured will see that it is wisely spent, and in such cases the necessary arrangements usually are made by the signing of an insurance trust agreement when the insurance is taken out. In the case of a sole proprietorship, however, the use of the insurance money must be delegated to some one else and the sole proprietor should select that

"some one else," either through the appointment of an executor under a well-drawn will or the trustee under a business life insurance trust agreement. It is sheer waste for a man to build up a business, make no provision for its liquidation or disposal in case of his death, and have it pass into the hands of an administrator appointed by the court who must deal with the business assets under rigid and arbitrary rules of law. Immediate sale of assets, irrespective of general economic conditions, is one of these rules.

There are two ways for a sole proprietor to arrange for his business interests in case of his death. If he has no specific program or agreement for the business to be taken over by some one else, then it is advisable to have it pass to his executor; that is, if the owner has no employees willing and able to make arrangements to buy and run the business, and has nothing more substantial than conjecture as to what *ought* to be done with it, then he should write his will, select a good trust company as executor, put in the most liberal provisions giving the executor full authority and discretion in all business matters and rely on the executor to see that the business is properly run until a purchaser for it can be found or it can be liquidated.

It may become necessary for the executor to continue the business for quite an extended period. It is therefore wise to provide in the will that the executor should incorporate the business, if he thinks it desirable, and hold the stock of the corporation in the estate without liability for loss. The reason for this is that, notwithstanding provisions giving the executor the most broad and liberal powers in continuing the

business, the executor will be personally liable on all contracts made as such executor. (*24 C. J. 59, Executors and Administrators; Willis v. Sharp, 113 N.Y. 586* [*1889*]; *Boulle v. Tompkins, 5 N.Y. Redf. Surr. 472* [*1882*]; *Matter of Gorra, 135 N.Y. Misc. 93* [*1929*].) This, of course, is a responsibility which no executor feels inclined to assume, though entitled to be indemnified out of the assets of the estate.

The other way applies in cases where the sole proprietor is able to make some definite program as to what is to be done with his business in case of his death. Obviously, the results are apt to be more favorable if a man works out his plan and has the purchasers committed to it in advance of his death, than if he merely leaves his business to his executor in the hope that the latter will be able to develop a purchaser who will pay a fair price. Particularly as men grow older and realize that their years of business activity are numbered, the importance of setting up a plan for the orderly sale and transfer of their business assets is borne in upon them.

There are in almost every business faithful and experienced employees who, if they had the means, would be not only willing but eager to take over the business of their employer at the time of his death. On the employer's side, it is quite evident that these men would pay a better price for the business than some one who is either a stranger to the business or a competitor. But if no steps are taken to help these men acquire the money to buy the business, they will not be able to raise enough ready cash when the proprietor dies to be entitled to serious consideration as purchasers. In

this situation the business life insurance trust attains a high measure of value. The sole proprietor's life should be insured, the policies deposited with a trustee under a business life insurance trust agreement and the employees should commit themselves to the purchase of the business in the event of the death of the proprietor.

The payment of the premiums is the real problem in perfecting this arrangement. Usually the employees have not sufficient means to pay the premiums on an amount of insurance commensurate with the value of the business or anything like that amount of money. In most cases they cannot make more than a nominal contribution; but this should not deter the sole proprietor from adopting the program. It is worth dollars and cents to his estate to have his employees committed to the purchase of the business instead of having a non-liquid asset in the hands of his executor or administrator. If necessary, the sole proprietor should pay all the premiums and the employees should undertake not only to buy the business, but to refund to the sole proprietor's estate the amounts paid by him for premiums during his life.

This arrangement cannot satisfactorily be put into effect and carried out without a business life insurance trust. The employees want to know that if they contract to buy the business, the money from the insurance policies will be paid to an impartial stakeholder and not to the executor of the sole proprietor's estate. From the standpoint of inheritance taxes, the sole proprietor is no worse off and may be much better off if the proceeds of the policies are paid to the

trustee under a trust agreement, than if the proceeds of the policies are payable to his estate.

Certainly some arrangement for sale or liquidation should be made from the day the sole proprietor starts in business. If the proprietor has to pay all the premiums, the exact method of putting it into effect should follow the principles which are stated for cases in which the whole matter is confided to the executor of the sole proprietor's estate. (See *infra.*) As the financial ability of the employees strengthens and they are able to share in the premium payments, the agreement may be modified accordingly. The modified arrangement should follow the general principles which are applicable to partnership cases. (See Part II, Chapters VI, VII, VIII, *infra.*) The methods prescribed for the valuation of partnership interests (Part II, Chapter VII, *infra*) and corporation stock (Part III, Chapter XII, *infra*) are equally applicable to the valuation of an entire business.

Technique

The Application

Except for cases where the employees participate in paying the premiums, as above outlined, the sole proprietor, being the only party in interest, should be the insured and should sign the application for the insurance on his own life.

It is commonly believed that some taxes can be saved if the application is signed by his wife instead. Some people think that if a man's wife signs the application for insurance on her husband's life, pays the

premiums on the policy (from money furnished by her husband for the purpose) and is herself named as the beneficiary of the policy proceeds, the money paid on the policy at the time of the husband's death need not be included as part of the husband's estate for the purpose of the Federal estate tax. For reasons hereinafter stated, this practice is not to be recommended unless the money to pay the premiums is the wife's own money, and even then there are certain disadvantages to the arrangement. (See *infra,* page 64.) Where the husband's business interests are concerned, it merely complicates matters.

The Beneficiary

There are two possible alternatives in the selection of the beneficiary for the proceeds of insurance policies carried for business purposes: (1) the insured's estate, or (2) the insured's wife or some other named beneficiary.

1. *The Insured's Estate.*—If the policies are payable to the insured's estate they are subject to both federal and state inheritance and estate taxes. (See *infra,* page 63.) Notwithstanding this, there is great merit, from a practical standpoint, in having all the insured's affairs concentrated in the hands of one executor or one group of executors and trustees under his will. Generally speaking, the value of having the policies administered by the insured's executor justifies the inheritance taxes that the estate would have to bear. While the tax burden may be somewhat reduced if the policy proceeds are payable to a named beneficiary, the slight advantage thus gained is more than

offset by the risk that money paid outright to a named individual may not be used for the purpose for which it was intended. The details of the precise amount of additional taxes to which the estate of the insured will be subject are more fully set out *infra,* page 71.

2. *The Insured's Wife or Some Other Named Beneficiary.*—Most women know little or nothing of their husbands' business interests. Except in most unusual cases, the wife is not the person best fitted to use the insurance money wisely in connection with the insured's business affairs. If the wife be named as beneficiary on the assumption of the insured, or perhaps on the implied understanding with the wife, that she will use the money to protect his business interests and will follow the advice of her husband's executor, there are two dangers: first, that the money will not be so used, and second, that as a result of the implied understanding the tax authorities will attempt to include the insurance as part of the insured's estate, in spite of the precaution. The only way to make sure that business life insurance will be used for the purpose for which it is taken out is to have it paid to the trust company that is to take charge of the sole proprietor's business interests after his death, as executor under his will, and to forego whatever tax advantage might seem to accrue under any other arrangement, such as having the wife named as beneficiary. (See *infra.*)

The same objections apply to the designation of a man's son, his attorney or any other individual as beneficiary of the policies.

The Law

Where a man is the sole proprietor of a business, life insurance applied for and maintained for the protection of his business interests and payable to his estate is on exactly the same basis legally as his private insurance. It is just the same as if he were not in business at all. The proceeds of the policies must be included in his estate in their entirety, and are therefore subject to inheritance and estate taxes of the state of his residence and of the United States. Premium payments are considered the same as living expenses and are not deductible from his income tax.

The legal principles involved in having insurance on the life of the husband applied for by the wife and payable to her as beneficiary upon his death should be fully understood.

The Federal Revenue Act of 1926 as amended by the *Revenue Act of 1928* provides:

> *Sec. 302.* The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated—(g) to the extent of the amount receivable by the executor as insurance *under policies taken out by the decedent upon his own life;* and to the extent of the excess over $40,000 of the amount receivable by all other beneficiaries as insurance *under policies taken out by the decedent upon his own life.*

The confident expectation of some enthusiastic underwriters that, if the transaction is carried through in the wife's name and she *appears* as the principal throughout as both applicant and beneficiary, the insurance proceeds will escape the estate tax, is quite

unwarranted. The Act says that the proceeds of policies taken out by the decedent upon his own life must be included as part of his estate. In furtherance of this principle, the Internal Revenue Department has promulgated *Reg. 70 Article 25* which provides, *inter alia:*

> Insurance is deemed to be taken out by the decedent in all cases where he pays all the premiums *either directly or indirectly,* whether or not he makes the application On the other hand, the insurance is not deemed to be taken out by the decedent, even though the application is made by him, where all the premiums are actually paid by the beneficiary. Where a portion of the premiums were paid by the beneficiary and the remaining portion by the decedent the insurance will be deemed to have been taken out by the latter in the proportion that the premiums paid by him bear to the total of premiums paid.

Neither the Act of Congress nor the regulation admit of escape from the tax by the adoption of a mere subterfuge. If the husband gives the wife the money with which to meet the premium payments, the mere fact that it is her check that goes to the insurance company is of no avail. Where a woman has an estate of her own and elects to use some of her own funds for the payment of premiums on insurance which she takes out on her husband's life, there can be no question that at the time of the husband's death the proceeds of the insurance policies are her property, since they were produced by the investment of her own funds and are, therefore, not a part of her husband's assets for the purpose of calculating the inheritance taxes on *his* estate. She has received the insurance

money through no act of or transfer from the husband. He merely happened to be the subject of the insurance. (It should not be overlooked that in case of her death, her estate includes in its assets the cash surrender value of the policies on her husband's life.)

It is equally true that where the wife is without independent means and the money for the premiums comes from her husband, the policies are in fact "taken out by the decedent upon his own life" and as such must be included as part of his estate.

In the last analysis it is a question of good faith. If the application is really made by the wife and the premiums paid by her from money of her own which she has elected to use for that purpose, then the insurance is not part of the husband's estate. If, on the other hand, the financial affairs of both husband and wife are so inextricably interwoven that what one does is the act of the other, if the husband turns over to his wife money, securities and other property and takes them back at will, if she disposes of assets which he has entrusted to her as he directs and without decision or inclination on her own part, then it is equally clear that the insurance is properly part of her husband's estate.

In the former case, there is no question of business insurance involved, for the sole proprietor is not protecting his business interests. The sole proprietor's wife is protecting her own interest in her husband's business, much as a creditor might; and that is a very different story. In the latter case, the result legally is the same as if the insurance were made payable to the insured's estate in the first instance.

The Cross Currents of Estate and Inheritance Taxes

No treatment of the subject of estate and inheritance taxes is complete without mention of the many so-called "estate tax" acts adopted in recent years by state legislatures. Every state, with one or two notable exceptions such as Florida and Alabama, has for many years had its own system of inheritance taxation. These have been variously designated by the states as "inheritance tax," "transfer tax," "legacy tax," or "succession tax." When a resident of any one of these states died his estate was subject to two taxes: (1) the inheritance tax of the state of his residence, and (2) the Federal estate tax. This double taxation has proven onerous and for a long time there has been an agitation that the Federal Government should withdraw from the field of estate taxes entirely or should reduce the amount of its levy. In response to this agitation the Federal Government has begun by allowing to each estate a credit on the amount paid for inheritance taxes to any state or states against the amount due the United States Government for the Federal estate tax. Under the Federal Revenue Act of 1926, as amended by the Act of 1928, a credit on the amount of the Federal estate tax due is allowed on account of any inheritance taxes paid to states up to 80 per cent of the amount of the Federal tax.

At the time this provision was embodied in the Federal estate tax law there were few states whose regular system of inheritance taxation on large estates amounted to as much as 80 per cent of the Federal estate tax. The tax officials in most states soon real-

ized that this peculiar 80 per cent provision in the Federal law would enable them to increase the tax revenues of the state appreciably without increasing the tax burden of the individual or his estate at all; that is, by superimposing upon the inheritance tax of the state an additional tax at a rate which would make the total state taxes exactly equal to 80 per cent of the Federal tax, the state would receive revenue up to the full amount of the 80 per cent of the Federal tax, the remaining 20 per cent going to the Federal Government.

An example will make this clearer. Let us suppose that the State of X had an inheritance tax at the rate of 1 per cent on all estates in excess of $100,000 and that the Federal Estate Tax Act in its present form was in force. John Doe, a resident of the State of X, died leaving an estate consisting of securities that are worth $400,000. The tax calculation would be as follows:

State of X Inheritance Tax..	$300,000 at 1 per cent..	$3,000
Federal Estate Tax..	50,000 at 1 per cent..	$ 500
	50,000 at 2 per cent.	1,000
	100,000 at 3 per cent .	3,000
	100,000 at 4 per cent..	4,000
	TOTAL..............	$8,500

Now in calculating the amount of Federal estate tax due, the estate would be entitled to an 80 per cent credit for an inheritance tax paid the State of X, or $6,800. The amount of tax actually paid the State of X, however, was only $3,000. Therefore the estate would pay total estate and inheritance taxes of $8,500,

payable $3,000 to the State of X and $5,500 to the Federal Government.

Now in this state of affairs it was very easy for the State of X to adopt an Estate Tax Act imposing an additional tax for the benefit of the State of X so that the total amount of all inheritance taxes which the State of X would receive would in every instance exactly equal 80 per cent of the Federal estate tax. In the case used as an illustration it would work out as follows:

State of X Inheritance Tax	$300,000 at 1 per cent	$3,000
State of X Estate Tax		3,800
	TOTAL	$6,800
Federal Estate Tax	50,000 at 1 per cent	$ 500
	50,000 at 2 per cent	1,000
	100,000 at 3 per cent	3,000
	100,000 at 4 per cent	4,000
	TOTAL	$8,500
80 per cent credit of amount of Federal Estate Tax due		6,800
Balance due Federal Government		$1,700

This subject has been presented in detail because of the direct bearing which it has upon the taxability of the proceeds of insurance policies. The state inheritance tax laws generally have exempted from their operation the proceeds of insurance policies on the life of an insured *payable to a named beneficiary.* The Federal estate tax, on the other hand, provides that all insurance carried by the decedent in excess of $40,000 *payable to a named beneficiary* shall be included as part of his gross estate for the purpose of

the Federal estate tax. In adopting their "estate tax" acts the states have made the taxable property conform to the Federal estate tax, with the result that the various state estate tax acts require the inclusion of all insurance carried by the decedent in excess of $40,000, even if payable to a named beneficiary.

This complicated state of affairs has raised the question whether the states which have adopted estate tax laws have not in effect nullified the life insurance exemption allowed by their regular inheritance tax laws and, if so, whether there is any advantage in having insurance in excess of $40,000 payable to a named beneficiary? Might not the insurance just as well be payable to the estate of the decedent? At first blush it would seem that there is no advantage in this.

Even under the existing laws, that is with the Federal estate tax, the regular state inheritance taxes and the added "estate tax" all in force, there are advantages in having the proceeds of policies payable to a named beneficiary instead of having them merely made payable to the estate of the insured. These advantages are:

1. If and when the Federal Estate Tax Act is repealed, there will probably be a saving in inheritance taxes.

2. The proceeds of policies are beyond the reach of the creditors of the insured.

3. The constitutionality of the requirement that the proceeds of all insurance policies carried by the decedent on his own life in excess of $40,000 be included as part of his gross estate for the purpose of calculat-

ing the *state estate taxes* has not been tested, and the constitutionality of these provisions is somewhat doubtful.

4. The constitutionality of the Federal estate tax as applied to the proceeds of insurance policies in excess of $40,000, payable to a named beneficiary, has not been tested *in its entirety* and it may be that decisions yet to be rendered may invalidate some Federal estate taxes already paid or yet to be assessed on the assumption that insurance in excess of $40,000 is taxable.

5. There are numerous states which have adopted inheritance tax laws at rates which, as applied to the larger estates, are so severe that they even *exceed* the 80 per cent of the amount of the Federal estate tax. In cases where this is true it is obviously not only an advantage, it is important that the insured have all his insurance in excess of $40,000 payable to a named beneficiary.

The precise result cannot be stated with certainty until the Federal estate tax has been repealed. Many of the state "estate tax" acts when adopted contained specific provision that they were to remain in force and effect only so long as the Federal estate tax remained in force and at that time were to be repealed automatically. The easy and welcome revenue to the state treasury which the state "estate tax" acts have furnished appears to have caused a change of heart on the part of many state tax officials, and there are intimations that even after the Federal estate tax has been repealed the states, or at least some of them, will continue their "estate tax" acts in effect as a part of

their permanent inheritance tax system. When this time comes, the attitude of the states on the taxability of the proceeds of life insurance policies in excess of $40,000 can be determined.

If they repeal their estate tax acts when the Federal estate tax is repealed, there will be a great saving in inheritance taxes, if the proceeds of life insurance policies are payable to named beneficiaries. If, however, the states do not repeal their so-called "estate tax" laws at that time, there may be no inheritance tax advantage in having the proceeds of insurance policies in excess of $40,000 payable to a named beneficiary. The result will be different in the different states.

To illustrate in detail how these laws operate to-day in two different states with different inheritance tax policies, calculations of the taxes due on four estates have been made. In the first case, the taxes are calculated for a resident of Massachusetts owning $400,000 general assets and carrying $100,000 life insurance, all property being left outright to the wife or in trust for her benefit, the wife also being named as the beneficiary of the insurance policies. In the second case, the result is shown for another resident of Massachusetts owning $1,900,000 in general assets and also carrying $100,000 in life insurance, the wife being the party in interest as in the first case. In the third and fourth cases, the taxes payable are calculated on corresponding estates for residents of Ohio instead of Massachusetts. In all four cases the Federal estate tax must be calculated as well as the inheritance and estate taxes of the state of residence.

The amounts subject to tax would be as follows:

	$500,000 Cases	*$2,000,000 Cases*
Federal ($100,000 general exemption, $40,000 specific exemption for insurance proceeds in addition)	360,000	1,860,000
Massachusetts (No general exemption, insurance payable to a named beneficiary not taxable)	400,000	1,900,000
Ohio ($5,000 general exemption, insurance payable to a named beneficiary not taxable)	395,000	1,895,000

The amount of taxes payable would be as follows:

	$500,000 Cases	*$2,000,000 Cases*
Federal tax, gross	10,900	120,900
Massachusetts tax	16,250	113,000
Ohio tax	12,700	72,700

It will be noted that in both the $500,000 and $2,000,000 cases the Massachusetts succession tax is considerably in excess of 80 per cent of the amount of the Federal estate tax, so that the special Massachusetts estate tax designed to take up the slack of the 80 per cent Federal credit has no chance to function. The same is true in the $500,000 case of the Ohio resident, but in the $2,000,000 case of the Ohio resident ($1,900,000 of general assets and $100,000 of life insurance), the Ohio inheritance tax is $24,020 less than

80 per cent of the Federal estate tax, and the Ohio estate tax absorbs this amount; that is, it imposes an added tax on the estate amounting to exactly $24,020.

Those most vitally concerned with this subject are the large policyholders and the large taxpayers, and the test of whether or not there is any tax advantage for them in having the policies of insurance on their lives in excess of $40,000 payable to a named beneficiary depends upon the rate of the regular inheritance taxes of the state of their residence as applied to their own estates.

The New York Legislature adopted in 1930 the Estate Tax as its only inheritance tax under a law effective September 1, 1930. This statute repeals the existing transfer tax and the special estate tax and substitutes for them a single Estate Tax, the rates of which in all brackets are exactly 80 per cent of the Federal estate tax rates. This new law provides that, in making up the amount of the gross estate, life insurance taken out by the decedent upon his own life and payable to named beneficiaries shall be included, "but only to the extent that such amount is required to be included in the gross estate under the provision for the taxing of estates contained in any Revenue Act of the United States applicable to the estate of the decedent"; that is, all in excess of $40,000. This is a very carefully worded provision and its full significance cannot be appreciated without thorough study.

The absolute exemption of $100,000 allowed by the Federal Government is not included in the New York law, the exemptions being only $20,000 for wife or husband and $5,000 each for children or other near rela-

tives; consequently the tax in the lowest bracket, 4/5 of 1 per cent, will be payable on many estates of moderate size which do not have to bear any Federal estate tax. Although the exemption of $100,000 allowed by the Federal estate tax is not granted by the New York estate tax, the proceeds of life insurance policies are treated specially, with respect to exemption, in the smaller estates. Thus *Sec. 249 r.—9*—after the provisions above quoted, continues: "of the amount so determined there shall be excluded from the gross estate hereunder, the difference between the amount of the exemption allowed in computing the net estate under such revenue act of the United States and the aggregate exemptions allowable under section two hundred and forty-nine *q* of this article."

For example, if a resident of New York carries $120,000 life insurance payable outright to his wife or in trust for her benefit, the entire amount will be free of the New York Estate tax, $40,000 enjoying the exemption under the Federal Estate Tax Act, the remaining $80,000 enjoying the special exemption extended by the new New York law. If the Federal Estate tax were abolished it seems clear that in cases of New York residents under the provision above quoted all life insurance proceeds payable to named beneficiaries would be exempt from the New York Estate tax, as there would then be no Revenue Act of the United States determining the extent to which life insurance proceeds should be included in the gross estate.

CHAPTER VI

PARTNERSHIP

The Use of Business Life Insurance Trusts in Partnership Cases.

The death of a partner means the termination of the partnership. If there is no special provision on the subject in the partnership agreement, the death of a partner automatically puts an end to the firm. If the partners agree specially that the firm is to continue in case of the death of one of their number, it is for a limited time only, usually until the end of the year in which the death occurs. The Uniform Partnership Act provides that the death of a partner shall terminate the partnership (*Uniform Partnership Law, Sec. 31* [*4*]) and just how long the partners may keep the firm alive by their written agreement, in advance, to that effect has never been prescribed by law or decision. It is quite true that the surviving partners often form a new firm and continue the business under the old name, but the business is then run by a new firm. The executor invariably demands payment in cash of the deceased partner's share in the old firm.

It is this element or characteristic of the partnership form of business organization that makes the business life insurance trust an important part of every well-organized and well-run firm. When the death of

any partner occurs, his interest in the business must be liquidated and retired. The surviving partners must meet that eventuality. The best way to meet this, as to meet any emergency, is to anticipate and plan for it. The business life insurance trust is to-day the accepted method for the retirement of interests in firms when one or more of the partners dies.

The well-being of the family of the deceased partner provides the impulse for the business life insurance trust. Every partner is glad to see an arrangement made to enable his associates to continue the firm business without interruption or impediment, but he is more vitally concerned that his own family shall receive the fair value of his interest in the business, a value that is full, free and usable for the living expenses of the family. In the presentation of the business life insurance trust, every member of the firm should be made to see that without such provision, his investment in the business will be a non-liquid asset of precarious and uncertain value.

The retirement of the interest of a member of any firm is a serious matter. It is particularly important when the partner in question was the owner of a majority interest or even a substantial interest in the business. Any business properly run keeps its capital employed, which means that while cash in bank must always be ample for current needs, surplus cash must not be allowed to accumulate. The money ordinarily on deposit is not in any way sufficient to retire the partnership interest of one of the members of the firm. How then is the interest of one of them to be liquidated and retired in case of his death?

There are only two possible methods: (1) to convert some of the other assets of the business into cash, or (2) to carry sufficient life insurance on each member of the firm, set up in a business life insurance trust, so that upon the death of any one of them, his interest in the business can be liquidated and retired. The former method is no method at all. It is merely an unfortunate situation resulting from the death of one of the partners. The only question for the surviving partners to decide is which of the assets of the firm can be sold with least sacrifice. The second method is sound, effective and reasonable in cost. Once put into effect, the partners need not be apprehensive that the business will suffer untoward consequences if one of their number should die. No matter when the death of a partner may occur, whether one week, one year or twenty years after the business life insurance trust has been set up, the means to retire the interest of the deceased partner are immediately available, provided, of course, the trust was set up correctly in the first instance and the partners have lived up to their obligations to make premium payments under it in the meantime.

In order that we may have a clear picture of the situation, a knowledge of the factors involved and a true appreciation of the dilemma in which the surviving partners sometimes find themselves, let us take a concrete case. In 1925, three men, A aged 45, B aged 32, C aged 25, entered into a partnership and began the sale of electrical supplies and equipment. They began business with $10,000 capital, of which A supplied $6,000, B $2,500 and C $1,500. Five years

have passed. The business has prospered beyond their fondest hopes. By living modestly and putting back as much of their earnings as possible into the business, the partners have increased the original capital of the firm from $10,000 to $180,000. Suddenly A dies. The firm has been doing business under a carefully drawn partnership agreement containing the usual provision that the death of any partner should not terminate the firm but that it should continue for a period of six months and that at the end of that time the partnership should end and the interest of each partner be liquidated.

In spite of the six months period of grace, the situation with which B and C are confronted is baffling. The possibility of their having to buy out A's interest in the business on six months' notice had never presented itself to their minds, especially in the form in which it has developed. The retirement of a $6,000 interest in a $10,000 business did not seem overwhelming, but the retirement of an interest of more than $100,000 in a $180,000 business is a different story. The capital of the firm is all profitably invested in stock in trade, accounts receivable and leases on real estate for their stores. B and C want earnestly to continue the business, but they find that A's death has crippled them. Although they have lost A's personal ability and initiative, this could be replaced if the business were undisturbed. However, the sale of sufficient assets to pay out $100,000 to A's executor at the end of six months means a sharp curtailment of operations, and the withdrawal of A's interest still further reduces their earning power, as the banks decline to

continue the same line of credit until the funds used to retire A's interest have been restored to the business from other sources.

It is for just such a situation as this that provision should be made. A, B and C should have foreseen what has occurred. They should have realized at the outset that the death of any member of the firm would prove an embarrassment to the business, and a business life insurance trust should have been established to counteract this effect. Had this been done and the face amount of the insurance policies increased from time to time to keep pace with the growth of the business, A's death would not have interfered appreciably with the progress and continued growth of the business. At the time of A's death, the trustee would have collected the insurance money, would have had the value of A's partnership interest determined, and from the money in its hands would have paid the amount so fixed to A's executor, procuring and delivering to B and C a full release of A's interest in the firm. B and C would then have owned the business and have been able to continue it without interruption and with only such diminution in earning power as A himself was able personally to contribute. An extreme case has been taken for purpose of illustration. The fact that in this particular firm, the business was so successful that the assets multiplied very rapidly does not affect the principle involved, since concerns with a more normal rate of progress face the same need.

It is not necessary to point out individual firms which should establish business life insurance trusts

to retire the interests of the various partners when they die. Every firm needs it. The task of the underwriter is not so much to convince the members of the firm of their particular need for business life insurance as it is to work out for them a program that will be effective, that they will understand, and that will not be prohibitive in cost. The task of the trust officer is to set up a business life insurance trust program that will accomplish its purpose at the least possible expense to the parties. The most satisfactory results follow the thorough and exhaustive collaboration of the two.

Types of Partnership

There are two main classes of partnership: (1) *the general partnership* in which all the partners have equal authority and are equally liable for the acts of the others and for the debts of the partnership; (2) *the limited partnership* in which one or more special or limited partners supply capital in a given amount to be subject to the risks of the firm, but in which the special or limited partners assume no personal liability beyond the amount of their capital subscription. Business life insurance applies to both classes of partnership with equal advantage, the value and importance of the insurance in the given case depending upon its circumstances.

We may eliminate from consideration all cases in which the insured is the applicant and has the insurance made payable to his estate, to his wife or some other member of his family direct, or to a trustee under an insurance trust agreement for the benefit

of dependents. These are cases of private insurance and not business insurance at all.

When the primary purpose of the insurance that is to protect the money value of the business interest of the insured has been served, there is a fund representing the liquidated partnership interest of the deceased in the hands of the trustee. It is always advisable that this money should be safeguarded by having it put in trust and not paid over to the members of the insured's family outright. As pointed out above, the persons ultimately and most vitally interested in the result are the family of the deceased partner. Although the money for the respective families usually is left with the same trust company, as trustee, that acted as trustee under the business life insurance trust agreement, the two trusts are separate and distinct. They are covered in separate trust agreements, and should not be confused.

An illustration will make the matter clearer. A, B and C, partners, enter into a business life insurance trust with the X Trust Company as trustee. Insurance is taken out on the life of each of the three partners in an amount equal to his capital investment in the firm, and the policies are deposited with the trustee. The trust agreement provides that upon the death of any partner, the trustee shall collect the proceeds of the insurance policies on his life and shall have the precise value of the insured's interest in the firm determined; that the trustee shall then hold the determined amount for the benefit of the insured's family in accordance with the directions previously given by the insured. While, theoretically, the direc-

tions for the disposition of the share of each partner could be stated in the insurance trust agreement, as a practical matter, this cannot be done at all. If A is an older man with grown children, both married and unmarried, B a younger man with children of tender years and C a bachelor with a maiden sister and no other relatives nearer than nephews and nieces who are the children of a deceased brother, we have a situation which it is not practical to cover in a single agreement. Any attempt to do so will result in a paper so complicated and involved that the prospective participants will be disgusted with the whole matter before anything can be done. A, B and C are all interested in the business and in a business life insurance trust, but B and C do not care in the least whether the money from A's interest in the firm goes to his wife or children. A and C have no concern with B's sons and daughters, and it makes no difference to A and B whether the money from C's interest goes to his sister and his nephews and nieces or to charity. Furthermore, a man's family conditions change constantly, and if a business life insurance trust were to be altered every time the family circumstances of a member of the firm changed, the negotiations would be interminable. The correct way in which the thing should be done is for A, B and C to set up a business life insurance trust containing the usual provisions as to the collection of the insurance moneys and the determination of the value of the partnership interest of the insured by the trustee. A should then execute a separate trust agreement specifying how the proceeds of his share of the partnership are to be distributed. B

and C should do likewise. Then the business life insurance trust may remain as originally drawn, until the needs of the business require a change. If there is a change in A's family and he wishes to rearrange the distribution of the money from his interest in the firm, he may do so by merely changing his own individual trust agreement without interfering with the business life insurance trust at all, or even without the other members of the firm knowing anything about it.

These are wholly distinct trust relationships which must not be confused. The first concerns the continuance of the firm, the relations of the partners to each other, and the use of the insurance money by the trust company as trustee to liquidate the interest of the deceased partner in the firm. This is the business life insurance trust with which this book deals. The second arises after the first trust has been completed, as it is entirely a personal trust.

CHAPTER VII

ARRANGEMENTS FOR INSURANCE PROTECTION AND DISTRIBUTION OF POLICY PROCEEDS

When the members of the firm have been assembled and have been convinced by the underwriter that their firm is in need of a business life insurance trust agreement, the machinery to set up the business life insurance trust should be explained. "Whose life is to be insured?" "Who is to apply for the insurance?" "Who is to pay the premiums?" These and many similar questions must be answered in the program which the underwriter proposes and presents. He should not wait for the partners to ask them. The answer to any one of the questions does not follow a set formula, but each depends in large measure on the other. "Who is to pay the premiums?" may be decided by "Who is to be the beneficiary of the trust?" The different phases of the trust and the insurance deposited under it should be studied and understood.

Life Insured

The insurance may be on the life of one or on several of the partners depending upon the purpose of the trust. If the main object is the retirement of a partnership interest, the insurance should be on the lives of the partners whose interests are to be retired. If on the other hand, the object of the trust is the pro-

tection of the credit position of the firm, the partner whose financial responsibility gives the firm its credit standing should be the one upon whose life the insurance is carried.

The Application

The application should be made by the insured, or by one of the other partners, on his life. This shows conclusively the insurable interest of the applicant. If the application is made by the insured himself, the likelihood of the proceeds of the policies being sought by the tax authorities for Federal estate tax is increased, regardless of whether the proceeds are so subject or not.

It is difficult to imagine a partnership case in which the insurable interest of the applicant is not readily apparent, for every partner has an insurable interest in the life of his co-partners. (See page 103, *infra.*) If there should be unusual circumstances which make it seem desirable to have insurance applied for and maintained for the benefit of some one without insurable interest, the requirements of the law cannot be circumvented by having the insured himself apply for the insurance under a prearranged plan by which he would immediately assign his interest in the policies to or for the benefit of some one without insurable interest.

Under circumstances mentioned above, the authorities are agreed on this point—that the insurance would be void from the beginning. (*Steinback v. Diepenbroch, 158 N.Y. 24* [*1899*]*; 37 C.J. 387, Life Insurance.*)

Payment of Premiums

The payment of premiums must be arranged in accordance with the financial ability of the parties in interest. There are three possible methods:

1. Each partner pays the premiums on the insurance on his own life.

2. Each partner contributes to a fund for the payment of premiums on the lives of one or more of the other partners.

3. The partnership pays the premiums.

1. *Each partner pays the premiums on the insurance on his own life.*—If the principal result desired is the protection of the credit standing of the firm in case of any partner's death, each may pay the premiums for the insurance on his own life. The death of a member of a firm frequently raises a question in the minds of bank and merchandise creditors as to whether the cash position of the business is in any way endangered by the death. If the deceased partner carried an ample insurance protection on his own life for the benefit of the firm, his death puts the firm in an easy cash position. Without the insurance, the firm would be under the necessity of finding means to liquidate his interest in the business. This would probably mean the use of all the cash that could be withdrawn from the business and the sale of other assets, usually at a sacrifice. The price at which the deceased member's interest in the firm is paid off is thus less than if the insurance were carried and the firm had plenty of ready cash in bank at the time of his death. On the other hand, if one member of the firm carries life

insurance for the benefit of the firm, it is a different matter. In effect, there is an increase in the capital of the firm coincident with the death of the partner. This pouring in of funds at a time when steps must be taken to liquidate the deceased partner's interest, either immediately or within a very short time, benefits the firm and the estate of the deceased partner as well. It fortifies the credit position of the firm and it obviates or postpones to a suitable time what would otherwise be a forced sale of a substantial part of the firm's assets in order to liquidate the interest of the deceased member of the firm. Thus, the value of the deceased member's interest in the firm is unimpaired or perhaps increased as a result of his death, while without the insurance, his interest in a firm pressed by its creditors and without sufficient ready cash to retire his interest would be considerably reduced. It is only in cases where the interest of the insured in the firm is overwhelmingly large that a partner carries insurance for the benefit of the firm, instead of for the direct good of his own family.

2. *Each partner contributes to a fund for the payment of premiums on the lives of one or more of the other partners.*—This is the most usual, and best plan. The creation and maintenance of a fund for the payment of the premiums is a practical method which can be varied to fit the number of partners, their respective capital contributions, ages and financial abilities. Thus in a case where there are three partners, each having contributed an equal amount of capital, all under 50 years of age, active in business and in good health, the problem is very simple. However, in

the case of a firm with ten partners, the senior partner being 58 years of age and having contributed 75 per cent of the capital, the other partners ranging in age from 45 to 29 years, with capital interests of amounts ranging from 6 per cent to 2 per cent, the difficulty of arranging for the premium fund is only exceeded by the urgent importance of having the life of the senior partner adequately insured.

As another example, let us assume a case in which there are four partners, A, B, C and D. The net worth of the firm is $100,000. A and B each have a 30 per cent interest in the firm, C and D, each 20 per cent. B, C and D apply for $30,000 life insurance on A's life and make up the fund to pay the first and subsequent premiums among them, B paying 3/7, C 2/7 and D 2/7 of the amount. Similarly A, C and D apply for $30,000 insurance on the life of B, A paying 3/7 of the premiums and C and D 2/7 each. A, B and C carry insurance on D's life and A, B and D on C's life and the premium payments on these policies are likewise made upon the same proportionate basis.

3. *The partnership pays the premiums.*—This is a combination of the two methods previously described. It is a convenient and easy way to provide funds for premium payments, but from a tax standpoint (both income and inheritance) it has the disadvantages but none of the advantages of the two preceding plans.

Allowances and Reimbursements for Premium Payments

No mention has yet been made of the problem of reimbursing the estate of the deceased partner for

the amount of premiums paid by him during his lifetime, perhaps with some allowance for interest. In any partnership business life insurance trust, this is one of the most important and at the same time most difficult subjects to be dealt with. There is no distinction between partnership and corporation cases so far as the principles are concerned. The matter has been dealt with *in extenso* in the consideration of corporation cases, Part III, Chapter XI, which should be studied, and the principles therein should be applied to all partnership cases as well.

The Responsibility of the Trustee in Premium Payments

One of the most serious duties undertaken by the trustee under any life insurance trust is the payment of premiums. It is vitally important that the records of the trustee be set up so that there can be no possible failure on the part of the trustee to pay the premiums as they fall due. If, through an oversight, the policies are allowed to lapse, it is quite possible that the subject of the insurance might, by that time, have become uninsurable, making it impossible to reinstate the policy by the usual method of paying up the back premiums. It has been suggested that under such circumstances the trustee might be liable to the parties in interest for the face amount of the policies which have been allowed to lapse. This result is so serious that a double check to assure the prompt payment of all premiums when they fall due should be set up in the records of the trustee and carefully followed.

Valuation of Partnership Interest

The valuation of the interest of the deceased partner is the crux of the agreement. There are several methods of determining this value:

1. *An arbitrary valuation.*—Although a fixed valuation is sometimes specified, it cannot do justice to all concerned. The worth of the firm is never constant; it changes with the change in business conditions, commodity values and volume of business. An arbitrary valuation fixed in advance may not even approximate the real valuation at the time of a partner's death and may be manifestly unfair either to the estate of the deceased partner or to the surviving members of the firm. It is not to be recommended as a basis for liquidation.

2. *Book value.*—This is a rather common arrangement and has the element of simplicity to recommend it. Accountants should be employed to audit the books of the firm and take off a balance sheet as of the day of the death of the deceased partner or as near thereto as is practicable. Using this as a basis, an effort should be made by the trustee to have all the parties in interest agree upon the valuation of the interest of the deceased partner, as reflected by the audit. There is a serious disadvantage to this, however, in that the parties in interest may be unable to agree and it does not make any allowance for the good will of the business.

A business built upon the trade name of its product should include a substantial item for good will. In a firm of long standing, with an established reputation

in certain lines of business, such as stock brokerage, the item of good will has great financial value. Professional firms—lawyers, architects, engineers—may have an established clientèle which will continue with the firm long after the death of one or more of the individual partners. Then, too, an individual who is preeminent may have contributed so largely to the success of a firm that the results of his work will not be fully realized, until many years after his death have elapsed. There are some cases in which good will is of no consequence but in the majority of cases good will is an item to be considered, and often it is the most valuable asset on the books of the firm.

3. *Current valuation agreed upon by the parties.*—Many trust agreements provide that the parties in interest at the time of the execution of the agreement are to certify to the trustee, by letter, the valuation placed by them upon the various partnership interests. The agreement further provides that they are to furnish similar statements at periodical intervals thereafter, usually every six months or year. This plan, while quite common, has both advantages and disadvantages. It has the element of simplicity, and the trustee, in operating under it, may do so without serious risk of liability if the agreement has been properly drawn. The disadvantages are that the parties may not be able to agree upon valuations or, what is more frequent, that they neglect to reach any conclusion on the subject and do not certify values to the trustee with any degree of regularity. Under these conditions, the liquidation price which is usually fixed by the last statement the trustee has on file, and based therefore

upon figures which antedate the death of the decedent by a considerable period, is not representative of the real value of the deceased partner's interest.

4. *Arbitration.*—This method also is quite common but it, too, has both advantages and disadvantages. The usual arrangement is for each of the surviving parties in interest and the estate of the deceased partner to appoint a representative to fix the value. These representatives, in turn, agree upon one or more additional persons, supposedly impartial, who will deliberate with the representatives. The arbitrators as a group then fix the value of the deceased partner's interest, and this valuation is supposed to be binding. The selection of the arbitrators and the deliberations of that group are apt to be cumbersome and tedious and there is always a question as to whether or not the findings of arbitrators under such circumstances are not subject to attack in court proceedings by any one who feels aggrieved.

5. *The valuation fixed by the trustee.*—There are not many trustees who are willing to make a direct finding as to the valuation of a partnership interest, but the most workable and satisfactory plan is to impose upon the trustee the duty of fixing the valuation. It is recommended that the agreement require the trustee to take off a balance sheet of the business as of some convenient date at or about the time of the death of the deceased partner. Using these figures as a basis, the trustee is authorized to consult one or more additional persons, usually some one who is thoroughly familiar with the profession or business in which the firm is engaged and is therefore qualified

to form an accurate value of its worth as a going concern. The trustee is authorized to be guided by and to rely upon the advice of those whom it has consulted, and to make its finding based upon the information which these persons have furnished. The agreement should provide that the finding of the trustee shall be final and conclusive upon all parties in interest. Under such provision, it is unlikely that the finding of the trustee could be successfully attacked and upset in any later court proceeding.

Collection and Distribution of Policy Proceeds

The Beneficiary

1. *Insurance payable to the estate of the deceased partner.*—The only advantage in having the insurance payable to the insured's estate is that it provides the estate with funds and makes less urgent the liquidation of the insured's interest in the firm. This, however, is an advantage accruing primarily to the insured's estate and not to the business, and the insurance under such an arrangement is in reality private insurance and not business insurance at all. We may therefore eliminate from consideration all partnership cases in which the policies are made payable to the estates of the deceased partners.

2. *Insurance payable to the firm.*—Where insurance on the life of a partner is made payable to the firm, it serves a threefold purpose.

(*a*) It compensates the firm for the loss in earning power sustained by the firm through the death of the partner.

(*b*) It puts the firm in a strong cash position in dealing with its creditors.

(*c*) It provides the firm with sufficient cash to liquidate the interest of the deceased partner.

There are disadvantages, however, to be found in this plan. Most important of these is that the estate of the deceased partner must bargain with the surviving partners as to the value of the deceased partner's interest. The surviving partners may decide not to liquidate the deceased partner's interest in cash, but to use the money for some other purpose. In other words, the liquidation of his interest is not automatic or assured. Furthermore, the money is subject to levy and attachment by creditors of the firm.

Another serious disadvantage is that the payment of the insurance proceeds to the firm increases the net worth of the business, thus proportionately increasing the value of the deceased partner's interest. This, in turn, adds to the difficulty of liquidating the interest of the deceased, and so defeats the very purpose for which the insurance was taken out.

3. *Insurance payable to the trustee for the benefit of the surviving members of the firm for retirement of the insured's partnership interest.*—This is the most common and probably the most satisfactory arrangement because, as a result of the operation of the estate, inheritance and income tax laws that are here applicable, the financial return to the parties interested is greater under this than under any other plan. (See discussion of applicability and exemption under these laws, Part II, Chapter VIII, *infra.*)

It is salutary to have a provision, in the agreement under which the partnership is organized, that the firm has no interest and is expected to have no interest in the policies which the partners individually carry on each other's lives.

Upon collection of the proceeds of the insurance policies the trustee will apply the money to liquidate the interest of the deceased partner. The agreement will provide that, if the sum from the insurance is insufficient for this purpose, the surviving partners may have the opportunity to make up any difference, on terms agreed upon in advance. If the sum available is more than sufficient, the trustee will distribute the balance as provided in the agreement.

In some cases, the partners agree that if the valuation fixed is lower than the face amount of the insurance collected, the whole amount of policy proceeds shall be paid over for the deceased partner's interest anyhow. This is a broad-minded provision which the partners feel they are justified in making with each other in order to protect the interest of any partner who may die in a period of business depression when the worth of the firm is less than might normally be expected.

The Duration of the Agreement and the Power to Change It

Partnership business life insurance trusts are usually made to continue until there is one survivor of the members of the firm. When such survivor has fulfilled all that is expected or required of him, he becomes

the sole proprietor of the business, and the business life insurance trust is at an end. Where, however, other partners have been admitted since the agreement was first made, it may continue beyond the duration of the lives of the original parties to it, if provision to that end is embodied in the agreement or in a supplement thereto, and no legal obstacle intervenes.

Rule Against Perpetuities

The agreement must be so drawn that it is not in contravention of the rule against perpetuities and the rule against restraint on alienation applicable in the state in which the contract is to be performed.

The ordinary common law rule that the ownership of property may not be tied up beyond a period of "a life or lives in being and twenty-one years thereafter" allows sufficient latitude to permit the inclusion of a considerable number of individuals comprising all the parties in interest, and in the states in which the English doctrine is in effect there is not much occasion to fear the effects of the rule against perpetuities.

In New York, where the suspension of the ownership of property is limited to two lives in being, the situation is more difficult. If there are three or more partners or three or more principal stockholders, the agreement must be so phrased that it will not extend beyond the period of two lives in being at the time it is executed. If, however, the title to the stock is not transferred to the trustee but the agreement may be regarded as a mere agency, the ownership of the

stock is not suspended but is merely qualified. Therefore, the rule against restraint on alienation is not applicable and presents no impediment. (See Part II, Chapter VIII.)

Power of Revocation

Careful study should be given the question of revocability of the business life insurance trust. In the absence of provision to the contrary, the agreement becomes irrevocable in character. The advantage of having an irrevocable agreement is that all parties to it are committed to a business insurance program from which they cannot withdraw.

This advantage, however, may be slight when contrasted with the serious disadvantage that may result if the agreement is so ironbound that no modification of it can be made under any circumstances. A sudden change might make the performance of the agreement, as originally planned, utterly impossible. General business conditions may undergo a complete reversal. One of the partners may become physically incapacitated. Sudden contraction of credit may render the loan or cash surrender value of the policies absolutely indispensable to the partners. A quarrel among themselves may upset all calculations with respect to the future. For many reasons it might become important to undo the arrangement that has been made. Certainly it should not be so loosely strung together that it can be undone on the slightest whim or fancy of one of the partners. It snould be possible to have the agreement set aside only in case of real necessity, and then only after the rights of all the

parties to the agreement have been fully protected and the financial loss to each resulting from the termination of the agreement reduced to a minimum.

An illustration of the involved situation that can result from the dissolution of the firm after the trust had been set up is contained in the case of *Ruth v. Flynn, 142 Pac. 194* (*Colo. 1914*). In this case, a policy of life insurance had been issued payable, upon maturity, to the firm. The policy contained the usual standard provision that "if the insured survive the aforesaid beneficiary (the proceeds should be paid to) the executors, administrators or assigns of the insured." The firm was dissolved and later the insured died. An attempt was made to collect the policies for the benefit of the creditors of the firm. The court held that the policies should be paid not to the firm but to the insured's estate. (*See contra Atkins v. Cotter, 224 S. W. 624* [*Ark. 1920*].)

Where there is any possibility that the interests of the partners may be prejudiced if they are all tied into an irrevocable agreement, then it should be drawn tight enough to compel every one to perform his contract though he may tire of it, but not so tight that it cannot be rescinded if all the surviving parties in interest are unanimous that the termination of the agreement is necessary. From a sales standpoint, the more latitude allowed in the termination of the agreement, the better. Just so long as it is not so loosely drawn that the partners can do each other injustice in withdrawing from it summarily, the more favorably the partners will regard it. They like to feel that if something unforeseen should make them want to can-

cel it, they will get back the insurance policies into their own control.

Creditors

One element which is not without importance in arranging business life insurance and particularly in setting up a business life insurance trust is the rights of creditors in case of possible insolvency. If the firm is directly interested in the policies through the payment of premiums or being named as beneficiary of the policies, the cash surrender value of the policies will constitute a firm asset and be subject to the claims of creditors at any time. If the insurance program is arranged so that the partners themselves furnish the funds to pay the premiums, the proceeds of the policies being payable to the trustee under the business life insurance trust agreement, the firm, as such, has no interest in the policies and they are not directly subject to the claims of the creditors of the firm.

Of course, a general partner is unlimitedly liable for the debts of the firm of which he is a member. In the event of insolvency, he would have to respond and his assets would be liable to execution for any debts of the firm which could not be satisfied out of the firm assets. It might, however, be a real advantage to the partners, in adjusting the financial obligations of the firm between them, to have the cash value of the policies in the hands of the trustee represent private assets of the partners individually, and not firm assets subject to immediate attachment. This is one of the many reasons why the program whereby the partners as individuals carry the insur-

ance on the lives of each other is recommended as most satisfactory.

Old Insurance and New Policies

Every business life insurance trust program involves some new insurance. In fact, the principal purpose of the underwriter in presenting the subject of business insurance to his policyholders and prospects is to sell new insurance.

The discussion which has preceded is intended fully to cover the subject with respect to new insurance, but in many cases, in fact in most cases, one of the partners or the firm itself may already have some insurance which he wants to include in the total for the business insurance program. There is no objection whatever to the use of insurance already outstanding. On the contrary, the whole trust might be set up with policies already issued. However, where old insurance is being used, care must be taken that the policies are not only brought under the insurance trust agreement but that there are no complications or tax disadvantages that, by the use of a little foresight, could be avoided.

The old insurance may consist of policies on the life of one or more of the partners which he himself has taken out or which has been taken out by the firm; or it may have been taken out by the insured and later turned over to the firm. This insurance must be so handled that it can be collected by the trustee immediately upon the death of the insured. It must also be put beyond the control of the insured so that

the purpose of the trust will not be defeated by a decision on his part or on the part of his creditors, to withdraw the insurance and surrender it for cancellation, pocketing the proceeds.

Vesting the Interest of the Trustee in the Policies

There are two methods of vesting the trustee with an interest in the policies so that the agreement may be made effective: (1) assignment, (2) change of beneficiary. If the payment of the proceeds of the policies at time of death were the only question involved, change of beneficiary would probably be sufficient, but there are other elements of great importance. These are the right to dividends, the right to the cash surrender value of the policies, the right to borrow on the policies and the right further to change the beneficiary.

The whole purpose of the agreement could be defeated by the dishonest or willful action of one of the partners with respect to the policies on his own life, if he were in position to do so. If the interest of the trustee is made effective through change of beneficiary alone, the insured under almost every standard policy issued to-day has full rights with respect to dividends on the policy, cash surrender value and loan value. The only way by which the full amount of policy protection will be made available to the trustee for the purposes of the agreement, beyond peradventure of doubt, is to have the insured execute both an assignment and a change of beneficiary on

every policy on his life deposited with the trustee. Otherwise, an assignment of interest executed by the insured after the agreement is in effect, or other action by him inconsistent with the terms of the agreement, might nullify the whole program and prevent the orderly liquidation of a deceased partner's interest.

CHAPTER VIII

THE LAW, INCOME AND INHERITANCE TAXES

The Application

The great advantage in having the application for the insurance made by the insured himself is that it eliminates all question of want of insurable interest. There is and never has been any question of the right of a man to take out insurance on his own life. *(37 C. J. 389 Life Insurance; Joyce on Insurance [2nd. Ed.] Sec. 887.)* The insurable interest of a firm or the partners, individually, in the life of one of the other partners is also generally recognized. *Conn. Mutual Life Insurance Co. v. Luchs, 108 U. S. 498 (1882); 37 C. J. 397, Life Insurance; Fleming v. Fleming, 184 N. W. 296 (Ia. 1921); Rahders v. Peoples Bank, 130 N. W. 16 (Minn. 1911); Rush v. Howkins, 68 S. E. 1035 (Ga. 1910).* The authority to the contrary, *Powell v. Mutual Benefit Life Insurance Co., 31 S. E. 381 (S. C. 1898),* is no longer considered to be the law.

There is a possible disadvantage in having the application made by the insured himself. It may subject the proceeds of the insurance policies or part of them to estate and inheritance taxes as part of the insured's estate, but the insurance contract is unquestionably valid. In partnership cases there is one complication

which must be guarded against. Although the law in most jurisdictions provides that, if the insurable interest exists when the policy is applied for, the cessation of the insurable interest will not invalidate the policy, there is athority for the claim that upon the termination of a partnership, the insurable interest of the partner in the life of his co-partner ceases. *(Ruth v. Flynn, 142 Pac. 194 [Colo. 1914].)*

Payment of Premiums

1. *Each Partner Pays Premium on His Own Life.*—The selection of the person or group of persons by whom the premiums are to be paid is a matter of first importance, because the payment of the premiums directly or indirectly is the test by which the Treasury Department ascertains whether or not the insurance proceeds must be included as part of the estate of the deceased partner. *The Federal Revenue Act of 1926* as amended by the *Federal Revenue Act of 1928* provides: "*Sec. 302.* The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated (g) to the extent of the amount receivable by the executor as insurance under policies taken out by the decedent upon his own life; and to the extent of the excess over $40,000 of the amount receivable by all other beneficiaries as insurance under policies taken out by the decedent upon his own life."

Regulation 70, Article 25 of the Treasury Department provides: "Insurance is deemed to be taken out by the decedent in all cases where he pays all the

premiums, either directly or indirectly, whether or not he makes the application." It is to be noted that the Regulation of the Treasury Department is more than an interpretation of the Federal Revenue Act of 1926. It is an extension of it. The Federal Revenue Act deals with insurance *"taken out by* the decedent on his own life." The Regulation states that the Department considers the insurance as *"taken out by"* the decedent if he paid the premiums on it, directly or indirectly. The Regulation of the Treasury Department is not law, nor has it the force of law. The Department has been obliged to make extensive revisions in its regulations at different times as the result of court decisions contrary to its rulings; but the regulations of the Treasury Department are the rules which the Department applies in assessing and collecting the Estate Tax under the Federal Revenue Act of 1926 until the Department is compelled, as a result of court decision, to revise its regulations. Under the law and regulations as they now stand, therefore, where a partner pays the premiums on insurance on his own life and the policies are payable to the firm as beneficiary, the proceeds of the policies must be returned as part of the estate of the insured.

For discussion of the method to be adopted in including the policy proceeds in the estate tax return of the insured's estate, the amount at which such policies should be listed, and possible exemption, see p. 111, *infra.*

The premiums paid by the insured are not deductible by him as a business expense when making his return for Federal income tax. While the *Federal*

Revenue Act of 1926 as amended by the *Act of 1928* provides: "*Sec. 23.* In computing net income there shall be allowed as deductions: (a) Expenses.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business"; there is the further provision: "*Sec. 24.* Items Not Deductible. (a) General Rule.—In computing net income no deduction shall in any case be allowed in respect of (1) Personal, living or family expenses. . . ." Life insurance premiums on policies on the insured's own life are regarded by the Treasury Department as a personal expense and are therefore not deductible, though the purpose of carrying the life insurance may be the protection of some business interest of the insured. *Nussbaum v. Commissioner, Binge v. Commissioner, Prentice-Hall Federal Tax Service* § *1021*. Even if the policies were taken out for the special purpose of and used as collateral for firm loans, the premiums paid by the insured would not be deductible. *(Rieck v. Heiner, 25 Fed.* [*2nd*] *453* [*1928*]*)*. The theory is that the funds are used to enhance the value of the insured's interest in the firm. They are a form of saving and not an actual disbursement, and therefore are not entitled to be treated as out-of-pocket disbursements made in connection with the business. Ultimately the money outlay is returned to the insured or to his estate *(Matter of McKay, 10 B. T. A. 949* [*1928*]*)*. Where, however, two partners make it a condition of their capital contribution that a third partner take out and carry insurance on his own life payable to them individually, none of the proceeds of the policies being available for the satisfaction of a debt of the firm

or of the insured, the premiums are a proper deduction from the insured's income tax return. *(I. T. 1340, Int. Rev., Cum. Bul., June, 1922, p. 119.)*

2. *Each Partner Contributes to a Fund for the Payment of Premiums on the Lives of One or More of the Other Partners.*—This is the most common arrangement and while accomplishing the principal objects of business life insurance, it is subject to none of the disadvantages of the other arrangements. It provides a fund immediately available to the surviving partners for the protection of their credit position, if need be, and for use in liquidating the interest of the deceased partner in the business. It need not be included as part of the estate of the deceased partner for Federal estate tax purposes because it is not insurance taken out by the decedent on his own life within the law or regulations. While the contributions to the premium fund by the partners cannot be deducted by them from their income as business expenses (*Matter of McKay, supra*), the face amount of the insurance policies, when paid over to the surviving partners or to the trustee for their benefit, is not income of which they must make a return and on which they must pay a tax. *The Federal Revenue Act of 1928* provides: "*Sec. 22* (b) Exclusions from gross income. The following items shall not be included in gross income and shall be exempt from taxation under this title: (1) Life insurance.—Amounts received under a life insurance contract paid by reason of the death of the insured." *Regulation 74, Article 82* provides: "The proceeds of life insurance policies paid by reason of the death of an insured to

his estate or to any beneficiary (individual, partnership, or corporation, but not a transferee for a valuable consideration), directly or in trust, are excluded from the gross income of the beneficiary."

3. *Where the Firm Pays the Premiums.*—Under this plan the insured is paying premiums on his own life to the extent that a proportionate share of the premiums on the insurance on his own life is withheld from the proportionate share of income of the firm which would be otherwise distributed to him. To the extent that the premiums on the insurance on his own life are provided from his own funds, the proceeds of the policies of insurance on his own life are subject to estate tax. The valuation of the deceased partner's interest in the firm should be based upon that proportion of the insurance which his own premium contributions supported. (See *infra,* p. 106.)

Premiums paid by the firm on the lives of the partners are not deductible from the firm income, even where the policies were used as collateral security for a loan. *Matter of Chandler, 3 B. T. A. 146 (1925).*

The Beneficiary

1. *Insurance Payable to the Estate of the Deceased Partner.*—Where the insurance is payable to the estate of the deceased partner, it is in effect private insurance and the results, legally, are just the same as in the case of sole proprietorship.

2. *Insurance Payable to the Firm.*—Where the insurance is payable to the firm, upon the death of a partner, the proceeds of the insurance policies on his life are not income to the firm nor to the individual

partners (page 107, *supra*) for the purpose of the Federal income tax.

Where insurance on the life of one of the partners is made payable to the firm of which he was a member, there is clearly some liability for Federal estate tax on the part of the deceased partner's estate for that insurance. The questions are: (1) how should the insurance be shown in the estate tax return of the deceased partner, (2) at what figure should it be shown, and (3) what, if any, exemption is applicable.

As above pointed out, the *Federal Revenue Act of 1926* as amended by the *Federal Revenue Act of 1928* provides: "*Sec. 302.* The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated—(g) to the extent of the amount receivable by the executor as insurance under policies taken out by the decedent upon his own life; and to the extent of the excess over $40,000 of the amount receivable by all other beneficiaries as insurance under policies taken out by the decedent upon his own life."

Regulation 70, Article 25 of the Treasury Department provides: "Insurance is deemed to be taken out by the decedent in all cases where he pays all the premiums either directly or indirectly, whether or not he makes the application."

Regulation 70, Article 28 of the Treasury Department provides: "Valuation of insurance.—The amount to be returned where the policy is payable to or for the benefit of the estate is the amount receivable. Where the proceeds of a policy are payable to a bene-

ficiary other than to or for the benefit of the estate . . . and only a portion of the premiums were paid by the decedent, the amount to be listed on such schedule is that proportion of the insurance receivable which the premiums paid by the decedent bear to the total premiums paid."

Applying these laws and rulings to the proceeds of insurance policies payable to the firm, there are two possible methods of showing the insurance proceeds on the Federal estate tax return of the deceased partner. They may be shown under the heading of "Life Insurance," or they may be included as an asset of the firm and as such are included and taken into consideration in determining the value of the deceased's interest in the partnership. It is submitted that the latter is the correct method. Certainly they will have to appear in one place or the other and they should not appear in both places.

The difference in result from calculating the Federal estate tax based upon the two different methods of return will be readily apparent. If the insurance proceeds be included under the heading "Life Insurance," the amount of the insured's estate will be increased by the proceeds of the policies, let us say, $50,000. If, on the other hand, the $50,000 is merely included in the assets of a firm in which the deceased partner had a 10 per cent interest, the net result is that the total value of the deceased's estate is increased by only $5,000.

Now, theoretically, and following strictly the terms of *Regulation 70, Article 25, supra,* if the insured paid all the premiums on insurance made payable to the

firm, it would have to be included under the heading "Life Insurance" under the tax return, but it has not been the practice of the Treasury Department to require this. On the contrary, if insurance is payable to the firm and is taken into account in valuing the insured's interest in the firm, the Federal estate tax liability of his estate should be determined accordingly, and should not be increased merely because the insured himself paid all the premiums on the policies. This is the general practice of the government in such matters.

It seems clear beyond any question, that where the firm pays the premiums and the insurance is payable to the firm as beneficiary, the only method of including the insurance in the Federal estate tax return of the deceased partner's estate, under the law and regulations, would be that most favorable to the estate, i.e., including it as an asset of the firm in valuing the deceased partner's interest.

It is now generally established that in dealing with life insurance policies for tax purposes, the face amount of the policies should be used. In fixing the value of estates for inheritance tax purposes, the general rule is that the assets of the deceased shall be given the value they had immediately before the death or at the instant of death. A life insurance policy has only a cash surrender value until the death of the insured actually occurs. In a number of cases, astute executors or their counsel maintained that in dealing with insurance policies belonging to a firm or corporation, in order to fix the value of the interest of the deceased partner or stockholder, the cash surrender

value of the policies alone should be considered. This argument, however, has not prevailed and the value to be assigned life insurance policies in such cases is their face amount, and not merely their cash surrender value. *(Prentice-Hall Federal Tax Service. ¶23196.1. Appeal of Annie S. Kennedy, 4 B. T. A. 330 [1926]. Estate of Stephen K. Reed, 243 N. Y. 199 [1926].)*

Finally, as to the exemption, if the method followed in making the return which it is submitted is correct, and is in general permitted by the Federal tax authorities (that is, if the insurance is included as an asset of the firm of which the deceased was a member, and is not listed separately under the heading of "Life Insurance"), no question of exemption arises. If, on the contrary, through mistake or inadvertence, or upon the insistence of some zealous government field agent, the insurance is included under the heading "Life Insurance" in the Federal estate tax return, is the firm to which the insurance proceeds have been paid or are payable, "any other beneficiary" within the language of the Federal Estate Tax Act so as to entitle the estate of the deceased to the benefit of the $40,000 exemption? Certainly no formal recognition of the firm of which the deceased was a member as "any other beneficiary," in the form of a ruling, regulation or decision of the Treasury Department, has ever been vouchsafed and it would seem that the firm is not entitled to such recognition. Certainly the firm has no separate legal existence as an entity as in the case of a corporation, and the deceased had a vested interest therein. It might be plausibly argued that if

the insured was sufficiently concerned about the financial affairs of the firm to pay all the premiums on policies payable upon his death to the firm, his interest in the firm was so direct as to identify the firm with himself and his own estate to the extent that it should not be considered "any other beneficiary." The most that could be successfully claimed on behalf of the estate would in all probability be that the proportionate part of the policy proceeds which the other members of the firm would receive or to which they would be entitled should be considered as payable to "any other beneficiary" and entitled to the $40,000 exemption for such insurance granted under the terms of the Act.

3. *Insurance Payable to the Trustee for the Benefit of the Surviving Members of the Firm upon Retirement of the Insured's Partnership Interest.*—This is probably the most satisfactory arrangement. The proceeds of the policies do not constitute income to any surviving partner who receives them. The funds, when received by the trustee, are used by him to retire the interest of the deceased partner, and this operation in itself places the partnership in a strong cash position with its creditors, both present and prospective.

If the premiums on the policies have been paid by the insured, then all proceeds of the policies in excess of $40,000 must be included as part of the estate of the insured for estate and inheritance taxation. Of course, any personal insurance carried by the insured must be included in the total insurance in any such calculation. Where the premiums on the policies have

been paid by the firm, then the proportionate part of the insurance maintained by the insured's share of the premium money minus the $40,000 exemption must be included. Where, however, the other partners unite in maintaining the insurance on the life of the deceased partner, then none of the insurance is taxable in the insured's estate either as a specific item under the heading "Life Insurance," or in calculating the value of the insured's partnership interest.

Duration of the Agreement

Revocation

In all business insurance trusts care must be exercised that the provisions of the agreement do not contravene the Rule Against Perpetuities and the Rule Against the Suspension of the Power of Alienation. The limits of these rules of law in the state where the business insurance trust is to be performed should be ascertained.

In Pennsylvania, Massachusetts, New Jersey and most states of the Union where the old common law rule against perpetuities is in force, the problem is quite simple as the agreement can be drawn to continue "during a life or lives in being and twenty-one years thereafter." All the parties to the agreement or those who are apt to become parties to the agreement are living at the time the agreement is put in force and the only precaution that must be taken is to make sure that the language of the agreement is not so broad as to permit the admission of persons then unborn as parties to the agreement at a later date. This

is a question of draftsmanship and does not present a real obstacle to the setting up of the arrangement.

In New York, the rule fixing the limits of time during which funds may be tied up has been arbitrarily fixed at two lives in being. In New York, therefore, the duration of the agreement must be strictly held within the limits of this rule. This may be done in two ways: (1) The duration of the agreement may be limited on the lives of two specified individuals, with the implied understanding that, when the agreement terminates by the death of the latter of the two of them, a new agreement for a further period to the extent permitted by the statute will be entered into. (2) The duration of the agreement may be limited until the death of the second of all the parties to the agreement, on the same implied understanding that the survivors would renew the agreement and its operation on the same or generally similar terms for the further period permitted by the statute.

In cases in which the power of revocation of all parties to the agreement is extensive, the arrangement may be considered a mere agency and the Rule Against Perpetuities and Against the Suspension of the Power of Alienation may be largely ignored. *(Equitable Trust Company of New York v. Pratt, 117 N. Y. Misc. 708 [1922], 193 N. Y. Supp. 152 affirmed without opinion, 206 N. Y. App. Div. 689 [1923].)*

Business reasons usually make it advisable that the business life insurance trust be revocable under certain conditions. There is, however, a legal advantage in having it irrevocable in form. If the insured in the different policies divest themselves of all interest in

the policies on their own lives and have no reserved right to vary, alter or terminate the agreement, nor to assign or change the beneficiary of any policy on his own life, a real saving in Federal estate tax may be made. *(Chase National Bank v. U S., 278 U. S. 327 [1929]; Rauh v. Commissioner, 19 B. T. A. 993 (1930.)*

Outstanding Insurance

The only precaution that must be taken in having the assignment executed is to make sure that the assignment be made to some person or for the benefit of some person having an insurable interest in the life of the insured, for while the assignment of an insurance policy to a person having an insurable interest is universally recognized as valid (*37 C. J. 387, Life Insurance*), the assignment to a person having no insurable interest is of questionable validity. The trust company acting as trustee has such insurable interest, provided the person or persons, for whose benefit it will collect and disburse the insurance money have an insurable interest in the life of the insured. There are few partnership cases in which this requirement presents a real difficulty. Of course every partner has an insurable interest in the life of his co-partners and the firm has an insurable interest in the life of each member of the firm. (See page 103, *supra.*) A creditor of the firm has an insurable interest in the life of each partner. It is difficult to imagine any situation in partnership cases in which there would be any desire on the part of any one interested to have the insurance proceeds used for the benefit of any person without

insurable interest when the trust is set up, but if such should be the case, the authorities are divided on the question of whether such assignment would be valid. The law of the state in which the insurance is taken out and the law of the state in which the trust is to be performed should both be consulted to be sure that the assignment is valid.

There are four main theories on this subject which are totally at variance:

1. Under the first theory the courts hold that if the policy is valid in its inception, it may afterwards be disposed of by the insured to any person whomsoever and the assignee may recover the entire amount of the policy regardless of the amounts paid out by him. This rule is in force in New York, New Jersey, Massachusetts, Illinois, Connecticut, Maryland, Wisconsin, Georgia, Nebraska, Mississippi, Rhode Island, Oregon and probably Michigan. *(St. John v. The American Mutual Life Insurance Company, 13 N. Y. 31 [1855].)*

2. In the second group of states, the courts hold that the assignment is valid if the consideration passing to the assignor is not wholly disproportionate to the amount of the policy. This rule is in force in the United States courts, Pennsylvania, Kentucky and, in certain instances, Indiana.

3. In the third group of states, the courts hold that the assignment of a policy valid in its inception to one having no insurable interest or an insufficient insurable interest is void except as to the amounts paid for the assignment and for premiums. The balance of the proceeds of the policy goes to the insured's es-

tate. This rule is in force in Texas, Alabama, Virginia, Missouri and Tennessee.

4. In the fourth group of states the courts hold that the assignment to one having no insurable interest is totally void. This rule is in force in Kansas and in some cases in Indiana.

For detailed discussion and citation of authorities, see *3 L. R. A. N. S. 935.*

Although there may appear to be danger of complications in the tax situation by use of an assignment, this result does not follow and is not to be feared. While *Reg. 74 Art. 82* provides, *inter alia:* "However, in the case of a transfer for a valuable consideration, by assignment or otherwise, of a life insurance, endowment, or annuity contract, or any interest therein, only the actual value of such consideration and the amount of the premiums and other sums subsequently paid by the transferee are exempt from taxation," the trustee can scarcely be considered a transferee for a "*valuable*" consideration within the terms of the Regulation and the effect of this is offset by the provisions of *Sec. 22* of the Act itself. (See page 186, *supra.*)

PART III

THE CORPORATION

CHAPTER IX

THE USE OF BUSINESS LIFE INSURANCE TRUSTS IN CORPORATION CASES

The corporation as a form of business organization has certain characteristics and enjoys certain advantages which have made it the most important economic unit in the business world to-day. The United States Steel Corporation, the American Telephone & Telegraph Company, General Motors, and other great corporations have aggregate resources in excess of the wealth of the entire nation fifty years ago. At the other end of the scale, the small individual who has saved $10,000 and decides to start in business for himself forms a corporation and conducts his operations as an officer of the corporation. Between these two extremes, there are innumerable corporations of all kinds and sizes. Included in this category for the purposes of this book, are joint stock associations and Massachusetts trusts.

To-day, when two or more men decide to engage in some form of joint enterprise, either by contributing capital, or their services, or sometimes both, to the venture, they usually incorporate. There are several characteristics of the corporation which lead them to choose this instead of the partnership form of organization. Of these, two are the most significant: (1) in the absence of fraud, the stockholder is not liable for

the debts of the corporation beyond the amount of his capital subscription, (2) the corporation has continuous and perpetual existence and is not terminated or dissolved by the death of one or more officers, directors or stockholders.

Since the corporation possesses these attributes, it might be surmised that the death of an individual interested in the corporation would have no adverse effect upon the corporation. In the case of a very large corporation this is true in some measure, but the human element can never be entirely eliminated from business. The larger the organization, very often the more important and influential is the individual factor.

Where the corporation has attained great size, the directors who allow the corporation to become or continue as a one-man organization are not alive to their responsibilities. They have usually trained and developed several men, any one of whom is fitted to succeed to the office which becomes vacant. If the importance of an officer to a corporation is very great, it is because of his executive ability. There may be apprehension that the earning power of the corporation will be affected when the president has been removed by death. In such cases, business insurance is of real value, since it can offset, to some degree, the effect of his removal. The credit of the corporation, however, is not apt to be affected, or else the amount of credit used by the corporation is so large that the cost of carrying insurance on the life of the president to an equivalent amount is prohibitive. The change in stock ownership and control brought about by the

death of any individual stockholder in a large corporation is usually without serious significance.

In the small corporation, however, particularly the small corporation where the stock is closely held, it is a different matter. The death of an individual may have a ruinous effect upon the business of the corporation. The individual in question may have been the motive power of the business and have been responsible for its earnings. Very frequently the financial standing of a corporation is so uncertain that it cannot borrow money without the added endorsement of one of the individuals interested in the business, and the death of the important individual cuts off the source and basis of the corporation's credit supply. Business life insurance is a prime necessity in all such cases.

It is with respect to the third result which follows and flows from the death of an individual interested in the business—namely, change of stock ownership in the small, closely held corporation—that the business life insurance trust is of special use and importance. The reason for this is easily made clear. A corporation is run by its officers, who are chosen by the board of directors. The directors in turn are elected by the stockholders. The real control and direction of the corporation, therefore, ultimately rests with the stockholders. Unless there is whole-hearted coöperation and sympathy between officers, directors and stockholders, a corporation cannot be successful. Discord and quarreling are bad enough for any enterprise. They are ruinous to the small corporation.

The death of a stockholder in a small corporation

may precipitate a crisis in the affairs of the organization if an adverse interest is introduced in his stead. The more important the individual to the corporation, the more serious the effect which his death will cause. This is especially true when the person in question is not only a stockholder but an officer and director as well, which is usually the case. The change in the ownership of stock of the corporation from the individual in question to the executor or administrator of his estate and, after a time, to the legatees under his will or his wife and children (or their guardian) may bring about results that are both unexpected and unwelcome.

Inasmuch as the stockholders own the corporation, the officers and directors are responsible to them. When three or four men engage in a joint business enterprise in which they themselves are stockholders, officers and directors, they are responsible only to each other and so long as there is harmony between them there can be no untoward consequences. If one of them should die suddenly, the survivors as officers and directors of the corporation would find themselves accountable to complete strangers. At the instant of death, the ownership of the stock of the corporation would pass from their former associate to those whom he had designated under his will or, in the absence of a will, to those whom the laws of the state had selected for him as the natural objects of his bounty.

The significance of the accountability of the officers and directors to the new stockholder cannot be overemphasized. If the decedent owned a majority of the stock of the corporation, the wishes of the new stock-

holder, as to the selection of officers and directors and the policy of the corporation, would control. Even if the amount of stock involved is not large, a hostile stockholder can do untold harm. Not only will the personal relations with the officers and directors be acrimonious and bitter, but the progress of the business of the corporation is sure to be retarded. Nothing must be done by the officers and directors which is in any way in derogation of the rights of the stockholders, otherwise the directors will be personally liable to those who have been injured When the directors of a corporation realize that their every act is being scrutinized and that everything they do or authorize to be done may mean personal liability on their part, or long and involved court proceedings to justify their course of action, the inevitable result is to make them overcautious. The vitality of the corporation is destroyed. Stagnation follows, and the business languishes or dies.

The estate of the deceased stockholder is in an equally unfortunate and unfavorable position. The stock of a small close corporation is a precarious investment for any estate. There is no market for the stock. No sale of it can be made unless at a great sacrifice, if at all, and the future of the business depends too much on the ability and attentiveness of those in charge. The stockholder who died may have been the brains and energy of the business. Without him the value of the stock may be materially lessened.

The interests of all parties can be safeguarded and the unfortunate results of the death of a stockholder may be forestalled through the use of a business life

insurance trust. The general plan and method of operation in the corporation case is the same as in the case of partnership. The insurance is arranged on the lives of the individual stockholders in amounts commensurate with the value of their holdings. The policies are deposited with the trustee under a written agreement, which prescribes in detail the method by which the precise value of the holdings of the deceased stockholder in the corporation is to be determined, and the steps to be taken by the trustee in collecting the insurance and using the proceeds of the policies in payment of the purchase price of the stock which passes to the survivors are also set out in the agreement.

As pointed out in Part I, Chapter III, the business life insurance trust is not without value in corporation cases where the purpose to be served is other than the retirement and liquidation of the interest of a deceased stockholder. In all corporation cases where stock interests are involved, there is no other means by which a life insurance program can be as effectively and satisfactorily carried out.

CHAPTER X

ARRANGEMENTS FOR INSURANCE PROTECTION AND DISTRIBUTION OF POLICY PROCEEDS

Life Insured

In approaching every business life insurance trust case, there are several fundamental problems which must be solved before anything else is done. The decision on one point will not only have a bearing but will frequently decide other points. Thus, the selection of the beneficiary will be determined very largely by who is to furnish the money for the payment of premiums. The first question to be settled is "Who is to be the insured?" and the proper answer to this question (and to the other questions that follow it) cannot be arrived at, until a clear understanding as to the purpose of the business life insurance trust is had. What purpose or purposes is the business life insurance trust in the given case intended to accomplish?

Is it intended to compensate the corporation for the loss of earning power sustained through the death of an important executive? If so, obviously the executive is the proper subject for the insurance.

Is it intended to strengthen the credit position of the company? If so, then the person who is the important factor in the credit standing of the company is the one whose life should be insured.

Is it designed to furnish a fund which can be used to liquidate the holdings of a deceased stockholder? Then the life of that particular stockholder is the one to be insured.

The business life insurance trust program may be a combination of two or all of these purposes. It may be desirable to provide against the effect in several particulars which the death of one important official of the corporation may have. In fact, the business life insurance trust program is a general plan whereby the business may continue as a unit, without loss of earning power, without being hampered by financial stringency and without accountability to new, strange and perhaps hostile stockholders. The death of one or several individuals who are intimately concerned with the business as executives or owners might occasion any or all of these catastrophes. Each one interested in the business is naturally concerned over the possible adverse effect on the business which the death of each of his important associates might have, and wishes to offset this effect by compensating life insurance. This is the true function of the business life insurance trust, and by means of it the institution of life insurance is fulfilling its highest function, namely, replacing human values with dollars on the basis of the life value or earning power and capacity of the insured.

In approaching the question of the life to be insured, it is usually easy to determine that the life of a certain one of the officers is to be covered, but there may be uncertainty as to whether the lives of other officers should also be insured. This is primarily a

business question, not a legal one, and business considerations must furnish the answer. The importance of the individual officer to the business is only one of the factors. Age, general condition of health, the relative cost of insurance on the lives of the different officers must all be weighed with relation to the principal objects which the business life insurance trust is to accomplish. The kind of policy best suited to the purpose must also be considered. A twenty-year endowment policy on the life of a junior officer may sometimes accomplish the purpose more surely and at lower cost than a straight life policy on the president of the concern. Often a combination of the two will produce a result more satisfactory and less expensive than either form of policy alone. The purposes of business life insurance are never served by including a number so large as to make them eligible for group insurance, but, on the other hand, insurance on the life of more than one individual may be a distinct advantage to the corporation.

The Application

There are three possible applicants: the insured himself, the fellow officers, directors or stockholders of the insured, and the corporation itself. The person who is to apply for the insurance will be determined very largely by the source from which the premium payments are to come and who the beneficiary of the trust of the insurance proceeds is to be. The regular procedure of having the insurance applied for by the persons who are to pay the premiums is the best plan in these cases. The most important factor is that of

insurable interest. (See Part III, Chapter XIII.) The person signing the application must have a clear insurable interest in the life of the insured, to support the policy. Another important factor is that of estate and inheritance taxes. If the insurable interest of those who are to pay the premiums and to benefit from the trust is certain, then it is better for them to apply for the insurance direct. It avoids all question as to whether or not the insurance proceeds constitute part of the estate of the insured.

Payment of Premiums

There are several sources from which the premium payments may come:

1. Each may pay the premiums on the insurance on his own life.
2. Each may contribute to a fund to pay premiums on all the insurance, including the insurance on his own life.
3. Each may take out and pay insurance premiums on the life of one or more associates.
4. Each may contribute to a fund to pay premiums on all the insurance except the insurance on his own life.
5. The corporation may pay the premiums.

1. *Each Pays the Premiums on Insurance on His Own Life.*—This arrangement is nothing more nor less than private insurance. If the death of the insured will so cripple the corporation as to have a seriously depreciating effect on the value of the insured's own stock, then it may be advisable for him to protect his own investment against the effect of his own death. If in so doing he makes the insurance payable to the

corporation or for its benefit, he is making a liberal present to the other stockholders of the company. While such an arrangement is the protection of a business interest, it is no different from the protection of business interest in sole proprietorships (Part II, Chapter I, *supra*), and does not fall within the term "business life insurance trusts" as it is employed in this book.

2. *Each Contributes to a Fund to Pay Premiums on all the Insurance Including the Insurance on His Own Life.*—This plan is quite often adopted. Each participant is not only protecting himself and his investment against the effect of his own death but against the death of each of his associates as well. To the extent that the insured's contributions support the insurance on his own life, the plan is private insurance, pure and simple. To the extent that the insured's contributions pay premiums on insurance on the lives of his associates, he enjoys the protection against loss resulting from their deaths to the full amount of the insurance coverage.

While there is nothing fundamentally wrong with such an arrangement, it makes a somewhat complicated tax situation in the insured's estate. To the extent that the insured's contributions have supported insurance on his own life, the proceeds of the policies are taxable as part of the insured's estate for Federal estate tax purposes and either must be included in the assets of the corporation in valuing the stockholdings of the insured or listed separately under "Life Insurance" in the return. Furthermore, the estate of the deceased must bargain with the surviving participants

as to the value of the deceased participant's interest. The surviving participants may decide not to liquidate the deceased participant's interest in cash but to use the money for some other purpose. In other words, the liquidation of his interest is not automatic. Another disadvantage is that the money will be subject to levy and attachment by creditors of the corporation.

3. *Each May Take Out and Pay Insurance Premiums on the Life of One or More Associates.*—Where the number of persons interested is very small, an insurance program is sometimes set up, whereby each makes direct application for insurance on the lives of his associates. Thus in a $100,000 corporation owned 60 per cent by A, 20 per cent by B and 20 per cent by C, B and C would each apply for and pay the premiums on a policy of $30,000 on A's life; A and C would each apply for and pay the premiums on a policy of $10,000 on B's life; and A and B would each apply for and pay the premiums on a policy of $10,000 on C's life. Even for the retirement of a deceased stockholder's interest, this method of premium payment is very uncommon and in cases where the other purposes of business insurance alone are to be served this form of protection is rarely used. Just as every business man in the British Empire may take out insurance on the life of the sovereign to protect himself against loss resulting from the business depression accompanying a period of national mourning when the sovereign dies, so each man might protect his investment in the business by taking out separate policies on the life or lives of one or more associates; but this

arrangement savors more of a private insurance program and is not often adopted.

4. *Each May Contribute to a Fund to Pay Premiums on All the Insurance Except the Insurance on His Own Life.*—This is the most usual and for nearly all purposes the most satisfactory method of handling the premium payments. The premium payments are handled by the trustee from funds supplied by the parties in interest. Thus in the case given, B and C would furnish the trustee with money for the initial premium on the policy on A's life, and thereafter would pay over to the trustee, at regular or irregular intervals, amounts sufficient to meet the premium payments on the policy on A's life as these payments matured. Similar funds would be set up for the insurance on the lives of B and C. Whether the premiums should be paid in annual, semiannual or quarterly installments, whether dividends are to be applied in reduction of premiums, whether to resort to borrowing on the policies to keep them alive in case the funds are not forthcoming from the subscribers when due, all these are matters which the trustee should arrange for and handle. The parties to the agreement should not be burdened with such details but should be free to devote their undivided attention to the operation of the business.

5. *The Corporation May Pay the Premiums.*—This is the plan most generally favored by the parties in interest, for it has the element of simplicity and presents few complications. The corporation treasury is a convenient source from which the funds for premium payments may be supplied. It is perfectly fair if the

stockholders of the corporation are to benefit from the insurance program in proportion to their holdings in stock, but only too often the stockholders do not stop to consider whether it is the most economical plan and whether the results are fair to all concerned.

From a purely bookkeeping standpoint it is less trouble to the individuals to have the corporation pay the premiums, for usually the only source from which they can get the money to pay the premiums is by having the corporation increase their salaries or declare increased dividends on the stock, and such items must be returned by the individuals as part of their personal income for income tax returns. This, of course, increases the amount of income tax which each of them has to pay.

If the corporation pays the premiums, the individuals do not feel the pinch of the premium payments quite so keenly. As a matter of fact, the direct result to them through such an arrangement is very often less advantageous than if the corporation were to increase their salaries and they themselves were to pay the premiums. The reason for this is that the corporation is taxable on its income at the 11 per cent rate and, not being permitted to deduct the insurance premiums from its income as a business expense, the amount paid for premiums is in effect taxable at 11 per cent. On the other hand, there are many officers of corporations, particularly smaller corporations, whose personal income is not taxable at any such rate as 11 per cent. If the salaries of these individuals are not excessive, the corporation may properly increase the salaries by the amount necessary to permit the

individuals to pay the insurance premiums themselves. Under this arrangement, the corporation may deduct the increased salaries from the corporation income as a proper business expense. Although the individuals have to return their increased salaries for their personal income taxes, the rate at which their personal income is taxable is less than 11 per cent and a corresponding saving in the amount of income taxes, viewing the situation as a whole, is quite appreciable.

The payment of premiums by the corporation does not change the status of the matter with respect to Federal estate taxes at all. In effect the insured has been paying the premiums on the insurance on his own life to the extent that he owns stock in the company and thus he contributes proportionately to the premium payments. Accordingly, the proceeds of the insurance policies must be accounted for in the Federal estate tax return of the insured's estate at the time of his death, either as a specific item under the heading "Life Insurance" or, through the insurance being included as a corporate asset in fixing the value of the stock of the corporation, as an asset of his estate.

The Responsibility of the Trustee in Premium Payments

As was pointed out under partnerships, the payment of premiums is one of the most important duties of the trustee in any business life insurance trust. Since one purpose of an insurance trust is to prevent the lapse of policies for nonpayment of premiums by appointing an experienced and infallible agent to perform this work, it should receive scrupulous attention

from the trustee. To this end the trustee should set up a system of records to check up on all payment dates so that there can be no possible failure in paying the premiums as they fall due. The results of allowing policies to lapse are apt to be serious and the trustee might be liable for the face amount of the lapsed policies.

Deciding a Fair Allotment of Insurance

The financial ability and prospects of the different parties in interest play a large part in arranging the program. How much can the individuals pay? Where the interests of the various stockholders are nearly equal and they are financially able to support a program of full insurance coverage, a full-strength program is easily arranged, but where the interests of the stockholders are grossly disproportionate and the financial ability of some of them is limited, it is more difficult.

Suppose in the case of a $100,000 corporation the stock interests, instead of being nearly equal, were A, 90 per cent, B, 5 per cent and C, 5 per cent. Under such circumstances, the income derived by B and C from the business, whether in the form of dividends, salary or commission, would be woefully inadequate to produce a fund sufficient to pay premiums on a policy of $90,000 on A's life. Furthermore, it would be a matter of little importance to A that he should acquire B's stock or C's stock in case of the death of either of them, while it would be vital to both B and C, not only that A's stock should not pass into unfriendly hands, but that if either B or C were to die, his stock should pass to the survivor, or to A and the survivor jointly, or perhaps to A alone.

The cases in which the financial inequality is sharply marked are difficult to deal with, but are the very cases in which the need for business life insurance is so great as to be almost self-evident. If the full insurance protection for the different stock interests cannot be provided at once, at least a start should be made. A gradual program should be adopted until the insurance in the amount necessary is in force and the policies deposited with the trustee. Thus in the example given, B and C might take out insurance for $30,000 on A's life. At the end of two years this amount could be increased to $60,000 and at the end of four years to $90,000. The additional coverage to protect B and C from the results of A's death could be obtained in the form of new policies on the life of A obtained at the end of the two- and four-year intervals. It would be much better, however, if at the time the business life insurance trust was created and the $30,000 policy written on A's life, A could be persuaded to apply for and carry a policy of $60,000 on his own life which he would agree to assign to the trustee for the benefit of B and C, $30,000 at the end of two years and $30,000 at the end of four years, upon payment to A of either (1) the cash surrender value of the policies, or (2) reimbursement with interest for the premium outlay by A. Advantage would thus be taken of getting the insurance on A's life at the younger age. It is no injustice to A to expect him to make such an arrangement, and B and C are not objects of his charity in asking him to put the insurance into effect. It is a distinct financial advantage to A and to his estate to have B and C committed to

a program of saving that will provide funds sufficient to retire A's stock interest at the time of his death.

How are B and C to provide the funds necessary to meet the increased financial burden of the additional insurance at the end of the two-year and four-year periods? First of all, there is the normal and regular increase in earnings which is the natural result of industry, intelligence and experience. It is not unlikely that the family responsibilities of B and C will also increase during the same period, leaving a very slender margin of increased earnings to care for the added premium burden.

There are several measures that may be adopted. The first is to make sure that, barring unforeseen reverses, the earnings of B and C from the business will be sufficient to carry the whole insurance program. The second is to modify the insurance program so that the money paid to the trustee by B and C is used in part to pay insurance premiums and in part to buy A's stock from A. Thus in the case given: the insurance on A's life might be $30,000 at the outset, another $30,000 at the end of two or four years, the balance of A's $30,000 being acquired by the trustee over the two- or four-year period from surplus funds contributed by B and C and not required for the premiums on the $30,000 policy on A's life. The third method is to start with the $30,000 on A's life and provide that upon A's death the $30,000 is to be used in payment of the purchase price of his shares, B and C, however, to have the right to pay the balance due on the purchase price in installments over an extended period, say 3, 5 or 10 years. A's stock in the meantime

is to remain in the possession and custody of the trustee as collateral for the payment by B and C of the balance due. The fourth method is to use the loan values of the policies as a means of keeping the policies alive until the parties are financially able to support a full-strength insurance program. The fifth method is to use term insurance until the financial ability of the parties is sufficient to maintain straight life or one of the more expensive forms of policy.

CHAPTER XI

ARRANGEMENTS FOR INSURANCE PROTECTION AND DISTRIBUTION OF POLICY PROCEEDS (*Continued*)

Allowances and Reimbursements for Premium Payments

Should the business life insurance trust agreement provide that the estate or beneficiary of a deceased partner or associate stockholder receive not only the policy proceeds but also reimbursement of premiums paid by him on the policies of the survivors? This is an important and rather delicate question upon which there is much difference of opinion. The main viewpoints are as follows:

1. Ignore the subject entirely.
2. Return to the deceased's estate the premiums paid by him on the policies on the other lives.
3. Return to the deceased's estate said premiums with interest.
4. Return to the deceased's estate the cash surrender values of the policies on the other lives.

Let us assume a simple case in which several associates have insured each other for a sufficient amount to pay for each one's interest in the business upon his death, such interest then to become the property of the survivors, and the life insurance proceeds to be paid over to the decedent's executor. Decedent A

is the first to die. The policy on his life is in full force. Should his executor be paid the whole or any part of the premiums paid by him on the lives of the survivors, and, if so, on what basis? Should the whole amount of the premiums paid by him on the policies of his associates be turned over to his executor, or some portion thereof, or the cash values which have accumulated up to the time of his death?

Let us consider in some detail the four possible methods of dealing with the problem:

1. *Make No Allowance at all for the Premiums Paid by the Deceased.*—This is manifestly unfair, particularly where the agreement has been in effect for some time, or where the payments by the deceased, for premiums on the insurance on the other lives, have been substantial. Some underwriters feel that a discussion of this subject impedes the sale. While this is true in a measure, to ignore it means that the underwriter has failed in his full duty to his prospects and policyholders and when the results of his deliberate neglect are realized, criticism, protest and condemnation will be certain to overtake him.

2. *Provide that the Amounts of Premiums Paid by the Deceased Are to Be Refunded to the Trustee by the Survivors, and the Policies on Their Lives to Be Assigned to Them.*—This is a common provision. It is fair, although it does increase the financial obligation which the survivors have to discharge. Opinions are at variance as to whether this method or number four is the more desirable.

3. *Provide that the Amounts of Premiums Paid by the Deceased Plus Interest Are to Be Paid by the Sur-*

vivors to the Trustee and the Policies on Their Lives to Be Assigned to Them.—While this is a fair arrangement, as a practical matter it is very difficult to carry out. The interest calculations are so complex that the reckoning would be extremely difficult. This plan is not generally used.

4. *Provide that the Cash Surrender Values of the Policies on the Lives of the Survivors Are to Be Calculated, and the Amount to Which the Deceased Would Be Entitled on Surrender Shall Be Paid by the Survivors to the Trustee for the Benefit of the Deceased's Estate, the Policies on the Lives of the Survivors Being Assigned to them.*—This method also is eminently fair. It is simple and practical and is commonly used. It is regarded by many as the most satisfactory.

The problem has been stated in the simplest possible terms; and yet it is evident, from a brief consideration of the question, that there is no one solution which will be satisfactory in every case.

If this matter of fair adjustment is ignored or passed over hastily, it is sure to lead to misunderstanding when the day of settlement comes. It is safe to say that the question will be raised in many, if not most, cases when the proceeds become payable. Beneficiaries and surviving insured associates, alike, are apt to be dissatisfied because the matter was not discussed at the time the trust was established. If all parties agree to make no such allowance, it is wise so to state in the deed of trust in order to prevent future misunderstanding.

Assuming, then, that the question should be asked and answered in the original negotiations, let us dis-

cuss different ways of dealing with it, and, after that, consider how and when it ought to be brought up in making the sale.

The most logical solution seems to be to have the estate of the decedent reimbursed for the premiums he has paid for any insurance on the lives of the survivors. The sum due by the survivors is added to the amount owing by them for the retirement of the interest of the deceased. His interest is worth purchasing because it is assumed to be of increasing value. The survivors thus profit obviously at the expense of the decedent. The further expense incurred unsuccessfully for the right to purchase their interests may well be returned, and that arrangement is usually agreeable to all participants when considered in advance. It is a matter for mutual consent, rather than a legal or moral right.

The premiums which the decedent contributed were paid by him to enable him to purchase the interests of his associates at the time of their deaths. In the supposed case, he has not lived long enough to have the opportunity to buy either of those interests. However, he has paid enough to give the policies a definite cash value, and his estate should be entitled to that. As a matter of fairness, if there is to be any inequality at all in the arrangement, it should be in favor of the estate of the deceased stockholder because the survivors get the business.

Opinions of Successful Field Men

The authors have consulted a large number of successful life underwriters and trust officers as to their

practice. It is very interesting and helpful to get their different advices, all based on practical experience. The best suggestions received in this way are set out in the following paragraphs, though no names are given, since the information was contributed informally. The quotations are direct from trust officers and life underwriters.

(1) When A dies, the money which comes in has been provided by B's payments of premiums and is really B's money. It serves to purchase for B the stock or interest of A. In addition to this money there is the value of the insurance which A has been carrying on B—a provision for B's prior death which is now useless to A. A built it up and A should be entitled to the proceeds of it, which can be realized either by surrendering it or by selling it to B, the survivor, at its surrender value. The more interesting question, I believe, is whether A's estate should be entitled to the surrender value or to the premiums paid by A. We suggest the surrender value feeling that this is the sum which the policies are really worth and which can be obtained from the company. This plan, however, has the disadvantage that if A dies in the early youth of the policies, there will be no cash surrender value at all. Incidentally, this case has already come up in our practical experience. If, however, you give A's estate the premiums actually paid, and probably on this theory interest on such payments should be included in all fairness, this amount can be received only from B, and if B does not elect to purchase, the cash surrender value will perforce have to be accepted from the company.

(2) This is a matter that has caused me considerable concern in the various cases that I have handled. There is no question in my mind that merely turning over the insurance proceeds from the policy on the life of a deceased member is not a fair or equitable solution. My recom-

mendation for some time has been that the premiums themselves paid in on the policies still in force on the surviving members of the business should be repaid to the estate of the deceased member. I do not feel that the cash value itself is enough, as it takes some years before the cash value reaches a figure equivalent to the amount of the premiums paid in In fact, I am inclined to favor the addition of interest to the amount of the premiums at the time of settlement.

(3) I favor the method of having the surviving partner pay to the estate of the deceased partner not only the true value of his share of the business, but also the actual premiums the deceased partner has paid on the partnership insurance; otherwise, it is perfectly obvious that the deceased partner would be paying for the insurance that would purchase his own share of the business.

(4) While of course it should be arranged so that all stockholders will be treated equitably, there seems to be a tendency to favor the survivors in the event of the first to decease, presumably upon the theory that if he is reimbursed for his investment or the book value of his stock at the time of death, without taking insurance into consideration, he has received enough. Personally, I favor the provision to reimburse the estate of the first decedent for the amount of premiums which he has paid upon the lives of the other associates.

(5) The agreement provides that the estate of the deceased shall own the proportionate part of the cash value, not the premiums, of the policies on the survivors. To my mind the cash value forms the only fair basis of interest, because that is what the insurance company will pay for the contract if the survivors don't care to carry it on. In other words, the cash value, and not the sum total of the premiums, is the market or asset value of the policies on the survivors.

(6) We do not believe that the premiums themselves should be returned to the estate of the first deceasing

owner of a business interest. It does not seem to us to be proper because the insured had the benefit of the protection on the co-owners during the period between the purchase of insurance and his own decease. We do believe that he should receive in addition to the value of his equity in the business the cash value on the policies of his surviving associates, which has been built from the money which he has paid thereon.

(7) If three of us are associated as partners in a business, and insurance is carried to cover the purchase price for the interest of a deceased partner whenever death may occur, the expense has been equally and proportionately borne by the three of us while we lived with none of us knowing which one might die first. It would seem to me that if I were such a partner and knew that my estate was to receive proceeds of the policy on my life, leaving my partner to carry on the risks of the business, I ought to be perfectly satisfied with such arrangement. I think there always enters into such a problem the nature of the partnership and the type of business in which they are engaged.

(8) Where there is a business purchase agreement providing a basis for valuation of stock of a deceased stockholder which is to be turned back in exchange for the proceeds of life insurance policies, that agreement should not take into consideration any premiums which had been paid upon the policy by the deceased member of the corporation or firm. If it should so happen that the policy had been in force for several years, the requirement of including the return of appropriate amount of premiums paid by the deceased stockholder might in effect nullify the main object for which the insurance has been carried, by making a heavy demand upon the survivors.

These quotations show how widely men who are actually negotiating business life insurance trusts differ

in their ideas and practices on the question of "Proceeds plus Premiums."

It should first be observed that the important thing is to bring the matter up and dispose of it at the right time without allowing it to interfere with the sale. Second, it should be left to the parties to decide which method they wish to adopt rather than to force them to adopt one's own opinion of the method most appropriate for the case under discussion.

Combining the Advantages of Different Methods

If the parties ask for definite advice, the best idea is to state what has been done recently in similar cases. If a standard recommendation is desired, the following is worthy of consideration:

Let the deed of trust provide that, in addition to the proceeds, there shall be paid over in settlement of the decedent's interest the premiums contributed by him on the policies of his associates, if his death has occurred before cash values have accrued thereon. If cash values have accrued, then they, rather than premiums paid, shall be the measure of the additional return over the amount of the policy proceeds on his own life and other payments provided in the agreement. If a discussion ensues as to whether return of premiums would not be fairer than return of cash values, the decision may well turn on the standard of valuation which is being fixed on the respective interests. If that standard is low, return of premiums might better be added to proceeds; if that standard is high and satisfactory all around, then the addition of cash values would seem to be sufficient.

When cash values are to be paid over in addition to proceeds, such a program disposes of the troublesome question as to what shall be done before the policies are old enough to have accrued cash values.

An Important Detail To Be Handled Tactfully

As a matter of negotiation or salesmanship, this whole question can be made troublesome or helpful by its introduction at the wrong or the right time and in the wrong or the right way. In numerous cases, it can be left until everything else is arranged and the time has come to draw the deed of trust. It then becomes, like many other features of that instrument, merely an important detail which must be decided and which should not be made to appear too vital. Introducing it as of the greatest importance at the wrong time is like exaggerating the importance of some possible tax saving in connection with the placing of a life insurance trust.

In all such negotiations there is generally one man who is eager for details and with whom this matter may be taken up individually for final decision, and his finding will be in most cases acceptable to his associates.

The best and most persuasive talking point is to stress the real, fundamental need for a purchase and sale agreement backed by insurance. If such need is thoroughly recognized by the prospects, and if the trust plan has been drawn carefully to fit the circumstances of the case, its consummation will not be upset by the discussion of this small though important detail.

With careful handling, the prospects will see that the essential thing is to arrange the business life insurance trust itself, and the matter of return of premiums or cash value is only one of many small points to be settled to the best possible advantage of all concerned.

CHAPTER XII

ARRANGEMENTS FOR INSURANCE PROTECTION AND DISTRIBUTION OF POLICY PROCEEDS (*Continued*)

Stock Which Is Subject to Agreement

In almost every business life insurance trust great consideration is given to retirement of the stock interests of the parties to the agreement at the time of their respective deaths. It is not only important, it is the essence of the whole agreement that the stock ownership and transfer, and the custody of the certificates meanwhile be fully provided for.

All the stock of the corporation should be made subject to the agreement if it is at all possible to do so. In a small corporation, numbering less than ten stockholders, this can easily be done. In a large corporation it is of course quite impossible unless the stock has previously been deposited under a voting trust agreement and even then there would probably be no right on the part of the voting trustees to enter into a business life insurance trust on behalf of the stockholders. In a corporation of medium size where a very substantial majority of the stock is in large blocks in the hands of a few holders (let us say, 80 per cent of the stock belonging to five different individuals, the remaining 20 per cent being scattered in small holdings among a large number of individuals), all the large

stock interests should be parties to and their stock deposited under the business insurance trust.

The only way to have the stock put beyond the control of the parties to the agreement and tied up so that it will remain available to the trustee to carry out the terms of the agreement, is to: (1) have the charter of the corporation contain a clause restricting transfers of stock to those made in accordance with the terms of the agreement; (2) have a similar provision in the by-laws of the corporation; (3) have the stock certificates endorsed on their face with a statement to the effect that the stock represented thereby is subject to the terms of the agreement; (4) have the stock transferred into the name of the trustee and the certificates deposited with the trustee.

(Hassel v. Pohle, 214 N.Y. App. Div. 654 [1925]; Longyear v. Hardman, 219 Mass. 405 [1914]; Blue Mountain Forest Association v. Borrowe, 71 N. H. 69 [1901]; re Lindsay's Est., 210 Pa. 224 [1904]; Cook on Corporations [8th Ed.] Secs. 622c, 622d, 408.)

This arrangement, however, is not always practical. In the first place, the business operations of the company or of the individual stockholders may require that the stock be available as collateral for loans. If it is tied up in the hands of the trustee it cannot be used as collateral, and if the certificates bear an endorsement that the stock is subject to the terms of a business life insurance trust, it has little or no value as collateral. It may therefore be impossible absolutely to assure that the stock will not by some misfortune get into the hands of some innocent purchaser for value. However, if the above arrangement, which is

more desirable, can be made, the trust agreement must contain very full provisions with respect to proxies and ordinary cash and extraordinary dividends on the stock, and with respect to the readjustment of the relative rights and interests of the parties to the agreement when the death of one or more of the parties to the agreement occurs and the proceeds of the insurance policies are paid to the trustee.

If it is impractical to have the stock transferred into the name of the trustee and the certificates endorsed, the next best arrangement is to have the stock transferred into the name of and delivered to the trustee, but also to give the depositing stockholders the right to withdraw the stock subject to certain restrictions. Dividends on the stock should pass to the original stockholders and the trustee may file dividend orders for this purpose. The participants are also entitled to proxies to vote the stock for any purpose not inconsistent with the agreement. It is best to permit the withdrawal only for the purpose of use as collateral and the agreement should contain a covenant that the withdrawing stockholder will return the stock to the trustee as soon as it has been released by the lender. Of course, if the stockholder defaults on his loan and the borrower forecloses on the collateral, the other stockholders cannot hope to have the stock continue to be subject to the business life insurance trust and the purchaser on foreclosure will in all likelihood acquire the stock free and clear of any restrictions. The other limitations in the agreement should include notice to the trustee, who in turn will notify the other parties to the agreement of the intention to withdraw

the stock, and a certificate from the withdrawing stockholder that the withdrawal is being made for some purpose authorized by the agreement.

It may be that some of the stockholders will be unwilling to surrender the right to sell their stock. If this is the case, the agreement should provide that before the stockholder can withdraw the stock and sell it to any outsider he must first offer it to the other parties to the agreement and must give them a reasonable time, usually thirty days, within which to decide whether or not they wish to buy it. Upon the expiration of that period, the withdrawing stockholder is free to sell his stock on the outside.

Unless the stock can be transferred into the name of the trustee and the certificates endorsed, the covenants on the part of the stockholders should be comprehensively worded. A stockholder who has withdrawn his stock for some special purpose authorized under the terms of the agreement may wish not to redeposit his stock after the special purpose has been served. The agreement should be so drawn as to leave him no choice in the matter. In another instance a depositing stockholder may have acquired additional stock and may prefer to keep it free from the agreement. Here again he should have no choice in the matter, but should be required to deposit his stock. Of course when additional stock is acquired by any of the parties to the agreement, additional insurance protection is necessary.

One feature of the agreement which must be carefully phrased is that part of it which specifies the proportions and amounts in which the stock belonging

to the insured or held for his account by the trustee should pass in case of his death to the surviving parties to the agreement. Of course the most obvious arrangement is to have the stock pass to the survivors in the proportions which their then stockholdings bear to each other. This is very simple where the financial abilities of the different parties are sufficient to support their respective parts of the program of premium payments, but they may not all have sufficient means to do this, or the situation may change fundamentally in this respect after the deaths of one or more of the stockholders. Again there may be a special reason why in a given case the stock should not pass in proportionate shares, as in a case where the head of a corporation and its principal stockholder wishes to have his son, a newcomer in the business and a small stockholder, succeed to his (the father's) stock interest if the son so desires.

Valuation of Stock

The next step is to arrange a means of ascertaining the price which the insured's estate is to receive for the stock. It is very poor practice to attempt to fix in advance the value to be placed on corporate stock at the time of a man's death. If an agreement is signed to-day fixing $100 per share as the sale price of stock for the purpose of liquidating a shareholder's interest at the time of his decease and the agreement is in force for two years before any shareholder dies, the stock may be worth $250 per share or $20 per share when his death actually does occur. In the one case the insured's estate is the sufferer. In the other case the

purchasers of the stock are done a great injustice. The better practice is not to attempt to place any value on stock in advance but merely to prescribe the method to be used to determine the value when the death of the insured occurs and the transfer by the trustee is to be made. Book value as of some date at or near the death of the insured is sometimes used. While in some cases this may be far from the actual value of the stock, in others it may come quite close to it. In still other cases, the sale price is fixed at book value plus 10 per cent, 25 per cent, or some other arbitrary figure. In other cases in which the parties to the agreement wish to show their appreciation of pleasant business relations of long standing, a discount of 10 per cent or 20 per cent from the book value is prescribed.

Probably the most difficult element to value in arriving at the price to be placed on a stock is that of "good will." In strict business practice it cannot be ignored, although where the parties to the agreement are on unusually friendly terms this is sometimes done. In some cases, the entire value of a business may be good will. "Huyler's," "John Wanamaker's" and other nationally known companies have an element of good will in the name alone which is very valuable, yet these are or have both been until recently corporations, the stock of which was limited to the members of one family. Other instances where good will is an important element are firms of stock brokers and professional firms such as lawyers and architects. In other cases it may be of no importance whatever. Then, too, good will value may disappear abruptly. Style and

fashion changes may rob a company of its established market and the value of its good will may melt away overnight. The scope of this work does not admit of a thorough discussion of how the value of good will should be arrived at. It is merely intended to point out that the item of good will should be fairly and fully considered in fixing a valuation on the stockholdings of the insured. For full discussion and citation of authorities, see *Prentice-Hall Inheritance Tax Service,* ¶ *23154*.

There are a number of different methods in vogue to fix the valuation:

1. *An Arbitrary Valuation.*—As pointed out above, an arbitrary valuation is quite unsatisfactory.

2. *Book Value.*—This method of arriving at valuation is used in quite a number of cases. It has the element of simplicity. When one of the parties in interest dies, the books are balanced and the valuation shown is fixed by a certified public accountant or sometimes even by no one more authoritative than the bookkeeper of the concern. It is not a very thorough method of dealing with the subject, for in practically every case it does no more than come within striking distance of the actual value of the stock. In a recent case, tax purposes had made it advisable for a corporation to write up the valuation of every asset on its ledger. In so doing none of the parties realized that the price which the survivor would have to pay for the stock of his business associate who died unexpectedly within six months of the changed balance sheet, would be almost prohibitive. In many other cases where a very conservative accounting policy is followed, the

figures do not begin to show the real value of the corporation's assets. One item in the balance sheet which never reflects the true state of affairs is that of good will, as pointed out above.

These different factors, varying so widely in value from the amounts shown on the books of the corporation, make the book value of the stock far different from the actual value which should form the basis of every liquidation sale.

3. *Current Valuation Agreed upon by the Parties.*—This is probably the most commonly used method for fixing the price at which the interests are to be liquidated. The agreement provides that the parties in interest shall periodically certify the value of the stock to the trustee, the interval usually being not less frequently than annual. While this arrangement is perfectly fair, the objections to it are not without force. In the first place, fixing the valuation of the stock is a continual annoyance to the parties in interest. It may be the occasion of wrangling and dispute among them. If they neglect to certify the value to the trustee with reasonable frequency, the value in force at the time the agreement is to be performed may be entirely disproportionate to the real value of the stock. As a practical matter, the parties will certify the value to the trustee with marked regularity during the early years of the agreement but thereafter the matter will be neglected or indifferently attended to. Dissatisfaction with the result is sure to be evident when one of the stockholders dies.

4. *Arbitration.*—This method also is quite common but it presupposes a controversy and it also involves

delay. In some instances, the relations of the parties are completely harmonious and the price at which the transaction is to be concluded is arrived at without great difficulty or delay. Arbitration in such a case is wholly unnecessary. Partisan differences are much more apt to be accentuated if the group to fix the price is made up of those who feel that they have been selected to represent the seller on one hand and the buyer on the other.

A not infrequent outcome of arbitration proceedings is that the finding of the arbitrators is challenged and the result of their deliberations is made the subject of a lawsuit. While the result of having the price of the stock fixed by arbitrators is usually eminently fair, the mechanical operations in having the price arrived at by this method are cumbersome and the end is not attained without a certain amount of rancor.

5. *The Valuation Being Fixed by the Trustee.*—Few trustees are willing to accept the task of fixing the value of the stock on their own responsibility. The trustee is a stakeholder, an impartial representative of two groups with divergent interests (the estate of the deceased stockholder on the one hand, the surviving stockholders on the other), but it is not an arbitrator nor advocate. No trustee wishes to find itself in a position where it will have to justify its valuation to one group or the other who feels aggrieved. Certainly no trustee wishes to have its valuation made the subject of complaint or attack in a lawsuit and be compelled to interplead between two sets of contending claimants, submitting itself to the judgment of the court both as to the transfer of the stock and as to the dis-

tribution of the proceeds of the insurance policies. While the trustee may seem to be the logical person to fix the final value, it should never be a buffer and trust companies should guard against too lightly accepting a duty that may entail serious and far-reaching responsibilities.

The method for arriving at the value of the stock does involve the trustee as the central figure and, in the full discharge of its duty to persons interested in the trust, the trustee should have no hesitancy or reluctance in taking steps to see that the valuation is properly fixed.

The provision recommended is first that an audit of the books of the corporation be made as of some convenient date near the date of the death of the deceased stockholder and the book value determined therefrom; that the parties in interest be given full information as to the result of the audit and be given the opportunity to agree upon the price for the stock, in accordance with the general plan fixed for the valuation of the stock in the agreement. If they are unable to agree (and no pressure should be exerted to compel them to agree), the trustee should be authorized to appoint one or more persons to advise the trustee with respect to the value of the stock. In the case of a very small corporation one person, usually an outstanding leader in the business in which the company is engaged, would be most suitable; in the case of a larger company, three persons, usually an accountant, an engineer and some one representative of the particular industry or the business world in general. The agreement would then further provide that the trustee should be au-

thorized to accept the valuation thus found, certified to the trustee and accepted by it. This method of arriving at valuation of the stock has been found, in most cases, to be eminently satisfactory.

The agreement should further provide that the finding of the trustee shall be final and conclusive upon all parties in interest and that for any finding made by the trustee in good faith it should not be liable to any one. It is likely that under such provisions the value of the stock fixed by the trustee could not be successfully attacked in any later court proceeding.

When the price of the stock has been ascertained, the matter is not entirely closed. The insurance will almost certainly never equal the precise amount of the purchase price for the stock. If the insurance is more than sufficient in amount, any surplus remaining in the hands of the trustee belongs to the surviving parties to the agreement and should either be returned to them or should be held by the trustee for their benefit in the proportions in which they are respectively entitled to it.

In some cases, the parties in interest agree that if the valuation fixed is lower than the face amount of the insurance collected, the whole amount of policy proceeds shall be paid over for the deceased stockholder's interest, anyhow. This is a broad-minded provision which the parties in interest feel they are justified in making with one another, in order to protect the interest of any stockholder who may die in a period of business depression, when the worth of the corporation is less than might normally be expected. If, on the other hand, the insurance is insufficient in amount, the

surviving stockholders must be given the opportunity to make up the balance due, and the agreement must contain full provision for this. First of all, the proceeds of insurance less the trustee's commission should be paid over at once to the estate of the insured or for the benefit of his family. The surviving stockholders should execute and deliver to the trustee notes for the balance due. The latitude allowed the surviving stockholders in the matter of amount and maturity of payments for the balance of the purchase price should be fully covered in the agreement but there should be an unqualified undertaking on the part of the survivors to buy *all* the stock of the deceased stockholder in every case. Some men wish to have their business interests liquidated and their funds invested within a year of their death. Others, recognizing the financial limitations of their associates, sometimes allow as much as ten years' time for the payment of the full purchase price. In the latter case, however, the surviving stockholders are expected to make small payments at frequent intervals during the interim.

Collection and Distribution of Policy Proceeds

The normal method of making the business life insurance trust effective is to have the proceeds of the policies payable to a trust company or a bank with trust powers as trustee. The advantage and importance of this provision have already been discussed. Part I, Chapter III.

When business life insurance was first written, it was the practice to have the insurance paid direct to the parties in interest. This was unsatisfactory be-

cause, in many instances, the recipients of the insurance money failed or refused to apply it for the purpose for which it was intended, or applied it in a manner unsatisfactory to the family of the insured. In those cases in which the payees of the insurance moneys wished to perform their duties conscientiously and with meticulous care, they found the responsibility more serious and the work far more tedious than they had realized. Where the money is paid direct to the corporation or to the surviving participants, the estate of the deceased participant must bargain with the survivors as to the value of the stock. In a few instances attempts were made to have the terms of the business insurance written into the policies themselves but the insurance companies refused to accept the business, or so restricted their responsibility in connection with it as to make the attempt fruitless.

Experience has shown that a trustee is necessary for the proper carrying out of a business insurance arrangement. The trustee should have the custody of and should be the beneficiary named in the insurance policies. The trustee should, if possible, have possession of the stock. A corporate trustee, a trust company, is highly preferable. It does not die. It is never absent through illness or on vacation. It is impartial in the discharge of its duties. The ample capital resources of modern institutions are a guarantee for the faithful discharge of its duty as trustee which is not surpassed by surety bonds filed for that particular purpose.

Finally, when the trustee has collected the insurance moneys and has made such disposition of the

stock as the trust calls for, there will be a fund in the hands of the trustee for the family of the insured. Here the real object of the principal in entering into the business life insurance trust—namely, the protection of his family—finds its fulfillment. That money ought not to be turned over to them outright, any more than the money from the insured's private policies should be paid to them in a lump sum. That money should be invested and held in trust for the family of the insured. The arrangement for this should be made in a separate trust agreement signed with the trust company by the insured at the time the business insurance trust is set up. No attempt should be made in the business life insurance trust itself to cover the investment and management of the proceeds of all the different insurance policies. A business insurance trust agreement is apt to be a long and, at times, an involved agreement. It is not easy to provide in a few words for the relative rights of stockholders A, B, C, D and E. If an attempt were made to provide for the administration of insurance money for A's wife and children when he died and for B's brothers and sisters and principal charity when B died, and for C's unmarried daughters and grandchildren, the trust agreement would become so voluminous that it would be impractical. On the other hand, it is important to A that his money be properly administered. It is of equal importance to B that his money be properly administered, and so on. These matters should all be covered in separate trust agreements made by each party to the business life insurance trust, with the same trust company as trustee, each agreement containing min-

ute and detailed provisions as to the investment and administration of that particular fund and the distribution of principal and income thereof. Thus A would have a separate insurance trust with the Blank Trust Company as trustee providing for the investment of the insurance money received on the surrender of A's stock and the disbursement of principal and income to his family. B would have a similar agreement, and so on. The business life insurance trust should not provide that the money is merely to be turned over to A's executor. Even if A had a well-drawn will, all the money turned over to his executor would have to be included as part of his estate for Federal estate tax and for State inheritance taxes, while if the money were paid to the trustee under a private insurance trust, $40,000 of the money would be exempt under the Federal tax, and under the inheritance tax laws of most of the states none of the money would be subject to tax. For present status of these laws, see Part II, Chapter V.

Duration of Agreement and Power to Revoke or Alter Its Terms

It would seem preferable that the agreement be irrevocable in character, but while this has the advantage of certainty and definiteness it may have decided disadvantages. If the agreement has been partly performed, especially if the rights of minor children have become involved, the irrevocable character of the agreement might prove an obstacle to a merger or sale of the corporation. Changes in the capital structure important to the financial well-being of the corpora-

tion might be thwarted or delayed by the irrevocable character of the trust.

While the trust agreement should not be so loosely drawn as to permit the parties to it to withdraw from it at will, nevertheless there should be a loophole so that the agreement may be cancelled and the stock returned to the owners if the surviving parties in interest agree upon such cancellation. Also there is less sales resistance, less reluctance on the part of the principals to enter into the agreement if they feel they can withdraw from the agreement without being penalized too severely. There are any number of reasons why it is well to have some provision for revocation. In addition to the reasons given above, a tax statute might be so drawn as to include within its provisions a business life insurance trust and if one was set up so that it could not be cancelled, even if all the parties in interest agreed, a serious injustice might be done those most vitally concerned.

Rule Against Perpetuities.—This is entirely a legal question and is covered under that heading in the next succeeding chapter under the heading "Law."

Changes in Status of Parties after Agreement Has Been in Operation.—Another phase of the subject which should be fully thought out and covered is the adjustment of the rights of the parties to the agreement as a result of changes which take place after the trust is in effect. For example, let us take the case of a corporation owned by five stockholders in the following proportions: A, 60 per cent, B, C, D and E, 10 per cent each. A business life insurance trust agreement is entered into and C then fails to supply the trustee

with his share of the funds necessary to keep up the premium payments on the policy of A's life. What should be the result? Certainly the insurance should not be allowed to lapse. A and B, or either, should be permitted to make up the sum necessary and if this is done, the rights of A and B (or whichever one furnishes the money) in the insurance policies should be adjusted accordingly. Should C be permitted to reinstate his interest in the agreement and in the policies if he later wishes and is able to make payments of the arrears, or should he be penalized for his failure by being barred from further participation? Should his reinstatement be subject to the wishes of that one or those who have supplied the necessary funds during his default or should it be a matter of strict right on his part? If C defaults and either is unable or is not permitted reinstatement under the trust agreement, what credit should be given him for the subscriptions to the fund already made by him? When should the money to which he may be entitled be made available to him? Should any reimbursement he is to receive be in the form of cash or should C be required to wait until the policies mature and then be entitled to some proportionate part of the proceeds of the insurance policies when collected by the trustee?

A number of other developments may occur either when the business insurance trust is being set up or after it is in operation. Let us take the same case. A, B and C may wish to set up a business insurance trust but D and E are not interested and refuse to participate in it. It would probably be well to have the agreement so drawn that D and E could be admitted at a

later date if they suffered a change of heart, upon payment of arrearages or upon their assuming their proper share of the cost of added insurance protection.

Taking the same case again, let us suppose that, after the agreement was effective, A bought D's stock, thus increasing A's interest in the corporation to 70 per cent, and B bought half of E's stock, thus increasing his (B's) interest in the corporation to 15 per cent. The amount of insurance coverage should then be adjusted to conform to the changed stock interests, and the amounts required of the different parties to keep up the premium payments would have to be similarly revised.

Vesting the Interest of the Trustee in the Policies

Should the interest of the trustee in the policies be vested by means of (1) assignment, or (2) change of beneficiary? If the payment of the proceeds of the policies at time of death were the only question involved, change of beneficiary would probably be sufficient, but the right to dividends, the right to the cash surrender value of the policies, the right to borrow on the policies and the right further to change the beneficiary are elements of the contract which are of importance during the life of the insured.

The dishonest or willful action of one of the parties in interest with respect to some of these features of the policies might place the whole agreement in jeopardy. While change of beneficiary alone will care adequately for the proceeds of the policies at the time of the insured's death, the insured under almost every standard policy issued to-day would still have full

right with respect to dividends on the policy, cash surrender value, and loan value. An assignment of interest executed by the insured after the agreement is in effect, or other action by him inconsistent with the terms of the agreement, might nullify the whole program and prevent the orderly liquidation of the deceased stockholder's interest. The only way by which the full amount of policy protection will be made available to the trustee for the purposes of the agreement, beyond any peradventure of doubt, is to have the insured execute both an assignment and a change of beneficiary on every policy on his life deposited with the trustee.

Creditors

No business insurance trust is properly set up unless full consideration has been given to the effect of possible claims by creditors of the corporation. When the program is arranged there may be no clouds on the horizon, but it is always well to make an arrangement which will be advantageous to the principals and their families if the unexpected should occur. The corporation cannot maintain insurance for the benefit of some private interest of the principals. If the corporation pays the premiums, then the corporation will have an interest in the cash surrender value of the policies, and in event of insolvency the policies will be an asset of the corporation and, as such, available to the claims of the corporation's creditors. If, however, the stockholders themselves pay the premiums on the policies on the lives of each other, the proceeds of the policies being payable to the trustee for their respective fami-

lies, the corporation, as such, will have no interest in the policies or their cash surrender value and the policies, as such, will not be subject to the claims of the corporation's creditors.

CHAPTER XIII

THE LAW, INCOME AND INHERITANCE TAXES

Right of Officer to Take Out Insurance on Life of Fellow Officer and Right of Corporation to Take Out Insurance on Life of Officer or Employee

During the period when the principles of corporation law were in the making and the precise relations of a corporation with its officers, directors, stockholders and employees were not fully understood, there was some uncertainty as to the right of a corporation to take out and maintain insurance on the life of one of its officers or employees. In some instances such right was denied. (*Victor v. Louise Cotton Mills, 148 N.C. 107* [*1908*].) To-day the insurable interest of a corporation in the life of one of its officers or employees is almost universally recognized by decision. Thus in *Mutual Life Insurance Company v. Board, 115 Va. 836* (*1914*), the company carried insurance on the life of its president and general manager to compensate it for "loss of services in event of death." The insurance company contested the claim on the policy, on the ground that the company had no insurable interest in the life of its president. The court, after an extended review of the authorities, overruled the defense of the insurance company and held that the face amount of the policy was recoverable.

In *Wurzburg v. N. Y. Life Insurance Co., 140 Tenn.*

59 (1918), a policy was issued on the general manager of a company, payable to the company as beneficiary. The insurable interest of the company in its general manager was sustained, notwithstanding that he had severed his connection with the company two years before his death.

In *U. S. v. Supplee Biddle Hardware Co., 265 U.S. 189 (1924)*, Taft C. J. said: "Life insurance in such a case as the one before us is valid and is not a wagering contract. There was certainly an insurable interest on the part of the company in the life of Biddle" (its president).

In *Keckley v. Coshocton Glass Co., 86 Ohio St. 213 (1912)*, the insured with two other persons owned a controlling interest in a company and each of them took out insurance on his own life for the benefit of the corporation. In seeking bank credit, those interested in the corporation represented the insurance policies as assets of the corporation. The insured then sold his interest in the corporation and some time thereafter died. The court held that the company was entitled to recover the full amount of the policy, notwithstanding that the insured had sold his interest in the company and left its employ some two years before. (See also *Reilly v. Penn Mutual Life Ins. Co., 201 Ia. 555 [1926]; Rumsey v. N.Y. Life Ins. Co., 25 Hawaii 141 [1919]; Wellhouse v. United Paper Co., 29 Fed. 2nd, 886 [1929]; Baker v. Keet-Rountree Dry Goods Co., 2 S.W. 2nd, 733 [Mo. 1928]; 37 C. J. 391, Life Insurance.*)

In some states, particularly those in which some doubt existed as to the insurable interest of a cor-

poration in the lives of its officers and employees, statutes defining and establishing such insurable interest have been adopted. The Pennsylvania statute may be considered characteristic: "The term 'insurable interest' is defined as meaning in the case of persons related by blood or law, an interest engendered by love and affection, and in the case of other persons a lawful economic interest in having the life of the insured continue, as distinguished from an interest which would arise only by the death of the insured." (*Pa. Pamph. Laws 1921, 682 Sec. 412.*)

See also:

N. C. Laws 1909, Chap. 507.
Texas, Acts 1921, p. 165; 14 Vernons Cum. Tex. Stat., p. 380, Insurance Law, Art. 5048.
Virginia, Laws 1926, p. 667; 1926 Supp. Virginia Code, Chap. 147, E3777A.
Indiana, Acts 1923, p. 443; 2 Burns Cum. Ind. Stat. 8963.

Such statutes have been sustained. (*American Trust Co. v. Life Ins. Co. of Va., 173 N. C. 558* [*1917*].)

Right of Corporation to Take Out Insurance on Life of Stockholder

The question of the right of a corporation to take out insurance on the life of one of its stockholders is by no means answered by the decisions. It is fundamental that the applicant for the insurance must have some interest or reasonable expectation of advantage in the continued life of the insured. For the most part, the courts have been liberal in supporting the policies,

even though the amount of the pecuniary interest may appear to be less than the amount of the policy. (*Bevin v. Conn. Mut. Life Ins. Co., 23 Conn. 244 [1854]; Ulrich v. Reinoehl, 143 Pa. 238 [1891]; Mowry v. Home Life Ins. Co., 9 R.I. 346 [1869]*.) Where the amount of the policy is wholly disproportionate to the pecuniary interest in the insured life, there may be serious doubt as to the sufficiency of the insurable interest to sustain the contract. (*Cammack v. Lewis, 82 U.S. 643 [1872]*.) Ordinarily the relation of a corporation, as such, to one of its stockholders is not of such nature as to make the continued life of the stockholder of any significance to the corporation whatever. It may be important to the officers and to the other stockholders, but the corporation itself is little concerned with the continued existence of any of its stockholders. If one of them dies, his estate cannot withdraw the money from the business. It can sell the stock but that has no effect at all on the corporation as a corporation. New and inharmonious stockholders may thus be introduced into the circle and may prove very undesirable to the officers and to the other stockholders. These latter are the ones who should apply for the insurance on the life of the stockholder, not the corporation itself. A corporation cannot have much justification for insuring itself against changes in the personnel of its owners. Certainly in a large corporation, the corporation has no insurable interest whatever in its stockholders. In a small corporation, where the stockholder is nothing more than a stockholder, if the corporation has any insurable interest at all, it is very

slight and rests on very slender support. Where the stockholder is more than a mere stockholder, however, that is, where he endorses the corporation's paper or in some other manner participates actively in the business of the corporation, the insurable interest of the corporation in his life is unquestionable. In this instance, it is because of his status as a participant in the conduct of the business that the insurable interest of the corporation arises.

In dealing with the question of insurable interest in corporations, courts take the position that where the insurable interest is not established it is an *ultra vires* act for the corporation to apply for the insurance and pay the premiums. (*Victor v. Louise Cotton Mills, 148 N.C. 107* [*1908*].) The effect of this decision so far as officers or agents of the corporation are concerned was changed by statute in 1909, see page 172, *supra.*) Life underwriters frequently try to circumvent this by having all the stockholders of the corporation ratify and approve the application for insurance, and while this would stop the stockholders, it would not have any effect on creditors if the corporation should later find itself in financial difficulty. Some of the insurance companies refuse to entertain applications from corporations for insurance on the lives of their stockholders because of this possible liability to creditors at a later date.

One element which must always be taken into consideration in arranging for the payment of premiums by the corporation is the validity of an agreement whereby the corporation undertakes to buy its own stock. In several states a corporation is not permitted

to buy its own stock except from surplus, and the directors responsible for such purchase, in the event a surplus does not exist, are guilty of a misdemeanor, *N. Y. Penal Code 664*. When, therefore, an agreement is drawn under which the corporation contracts to buy its own stock, it must be carefully phrased so that it is to be operative and to be performed only in case the corporation has a surplus at the time of performance (*Topken, Loring & Schwartz, Inc. v. Schwartz, 249 N.Y. 206* [*1928*].) If, however, it is clearly stated in the agreement that previous to the purchase of the stock of the decedent by the corporation there must be an available surplus in the treasury of the corporation for that purpose, the agreement is of unquestioned validity. (*Cross v. Beguelin, 226 A.D. 349, affirmed 252 N.Y. 262* [*1929*].)

Payment of Premiums by the Insured

There can be no legal objection to this arrangement but, as pointed out above, where one applies for and pays the premiums on insurance on his own life, the result is a mere private insurance coverage, although the insured may have extensive business interests. The plan does not fall within the discussion of "business insurance" as that term is used and developed in this book.

Payment of Premiums by Corporation

The legality of this arrangement depends in large measure upon the importance of the life insured to the corporation. We are dealing here with two principles of law: (1) insurable interest, (2) *ultra vires*. The two

in many cases converge and coalesce but in some instances are separate and distinct. For example, a small corporation with a capital of less than $100,000 might take out a policy of insurance on the life of one of the junior officers of the corporation for several million dollars. The corporation would have an insurable interest in the life of the officer, but the sum insured would be so grossly disproportionate to the value of the officer to the corporation that the payment of premiums from the corporation's treasury would be an *ultra-vires* act.

So long as the face amount of the policy represents in not unreasonable measure the worth of the life insured to the corporation paying the premium, there can be no question of the right of corporation to take out insurance on the life of one of its officers, directors, agents or employees, and to pay the premiums thereon. Such an act is clearly *intra vires*. The value of the particular individual to the corporation cannot be ascertained by any established standards of measure. The potential earnings of a great motion picture star, professional baseball player, aviator, or inventive genius might justify life insurance in face amount several times the total capitalization of the corporation. Where the earnings of a corporation are derived from the intelligent use of fixed assets and raw materials, and the business is of such character that the personal attributes of the executives are not of great moment, and where the loss which the corporation would sustain would be a slight temporary let-down in the tempo of production, then the face amount of the insurance must be limited to a rather modest figure. So

long as the directors of a corporation act in good faith in fixing the value of the life insured to the corporation, and so long as the amount fixed is not so extreme as to be fantastic or ludicrous when considered with relation to the capital assets and sales volume of the business, there is no reason to doubt that the payment of premiums by the corporation would be sustained.

The question of insurable interest is not apt to be raised in cases of officers, directors and employees of corporations. The insurable interest exists and is substantial, notwithstanding *Victor v. Louise Cotton Mills, 61 S.E. 648 (N. C. 1908)*, and other early cases to the contrary. There is more serious doubt when the insurable interest is nominal and the premium payment substantial. It only too frequently happens that business life insurance programs are arranged by underwriters where the capital of the corporation is small in amount, where the insurance coverage is substantial, in fact large, and where some one proposes that it would be well to have the premiums paid by the corporation in the mistaken belief that by so doing there will be a magic saving of income and inheritance taxes. This is unwise. Where the amount of the insurance is disproportionately large, the payment of premiums by the corporation is *ultra vires*, particularly where the family or the estate of the insured is the beneficiary of the policy. (See *infra.*)

The *Federal Revenue Act of 1926* as amended by the *Federal Revenue Act of 1928* provides: "*Sec. 24a.* In computing net income no deduction shall in any case be allowed in respect of . . . (4) Premiums paid

on any life insurance policy covering the life of any officer or employee or of any person financially interested in any trade or business carried on by the taxpayer (the corporation) when the taxpayer (the corporation) is directly or indirectly a beneficiary under such policy."

Article 283, Regulation 74 of the Revenue Department provides: "Premiums paid by a taxpayer (the corporation) on an insurance policy on the life of an officer, employee, or other individual financially interested in the taxpayer's business, for the purpose of protecting the taxpayer (the corporation) from loss in the event of the death of the officer or employee insured are not deductible from the taxpayer's gross income." The form of policy is immaterial. So long as the corporation is the beneficiary, the premium payments are not deductible. (*O.D. 699, Cum. Bul., Dec., 1920, p. 192,* in which term insurance was involved.) Furthermore, even though the corporation agrees, by separate contract, to turn the proceeds of the policies over to beneficiaries designated by the insured, the amount paid in premiums is not deductible. [See *Omaha Elevator Co., 6 B.T.A. 817* (*1927*).] Where a corporation increased the amount of an employee's compensation by the amount of annual premiums on insurance taken out by him in favor of the corporation as beneficiary, the premiums were held not deductible. (*O.D. 688, Cum. Bul., Dec., 1920, p. 192.*)

Article 283, Regulation 74 further provides: "If, however, the taxpayer is not a beneficiary under such a policy, the premiums so paid will not be disallowed as deductions merely because the taxpayer (the cor-

poration) may derive a benefit from the increased efficiency of the officer or employee insured." At this point in the regulation there is a cross-reference to Article 53 and 126-129 of Regulation 74 which has to do with compensation for personal services.

There are a number of rulings on different cases which have been submitted to the Department, the net result of which may be summarized as follows:

A corporation which pays premiums on policies of insurance on the life of an officer or employee, the policies being payable to a beneficiary designated by the insured, may not deduct such premium payments from the corporation income as a proper business expense unless the corporation gains materially and appreciably from the increased efficiency of the officer or employee resulting from such insurance. Unless, therefore, the amount of insurance and the corresponding premium payments are limited to some modest sum such as is customarily paid as part of the welfare program in corporations of the same general size and character, the premium payments are not deductible by the corporation as a business expense. (*I. T. 2279, Cum. Bul., June, 1926, p. 67; O. D. 659, Cum. Bul., Dec., 1920, p. 192.*)

If the premiums are allowable deductions, however, the amount of such payments by the corporation constitutes additional compensation to the officer or employee insured and such sums must be included by the officer or employee as taxable income of his own. (*O. D. 627, Cum. Bul., Dec., 1920, p. 104.*)

On the other hand, the regulations expressly recognize that sums paid out by a corporation for group

insurance are proper deductions from the income of the corporation and are not income to the employees. (*Reg. 74, Art. 53.*)

Payment of Premiums by Stockholder

Although there do not seem to be any cases in which the right of a stockholder to take out and pay premiums on the life of an officer, director or employee of the corporation has been established, it seems perfectly clear that the stockholder has an economic interest in the continued existence of an important person in a successful corporation. The only limit upon the right of the stockholder in this respect would be that the insurable interest must be sufficient to justify insurance in the amount applied for; otherwise the transaction becomes a mere gambling contract.

Premiums so paid are not allowable deductions from the income of the stockholder as business expenses but are regarded as an investment.

Payment of Premiums from Joint Fund

One reason why the subscription fund, each contributing to the payment of premiums of insurance on the lives of others, is so generally adopted is that it obviates all question of Federal estate taxes, and of inheritance taxes, generally. As pointed out above, page 109, the *Federal Revenue Act of 1926* as amended by the *Federal Revenue Act of 1928* provides: "*Sec. 302.* The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated—to the extent of

the amount receivable by the executor as insurance under policies taken out by the decedent upon his own life; and to the extent of the excess over $40,000 of the amount receivable by all other beneficiaries as insurance under policies taken out by the decedent upon his own life" *Reg. 70, Art. 25* of the Treasury Department provides: "Insurance is deemed to be taken out by the decedent in all cases where he pays all the premiums, either directly or indirectly, whether or not he makes the application." It is quite obvious that where the business life insurance trusts are round robins of self-protection, the parties uniting to protect their own interests against the deaths of one another, the insurance proceeds are not part of the estate of the insured who dies. It should not be forgotten, however, that the decedent may and doubtless did have an asset of no inconsiderable value in his interest in the business life insurance trusts on the lives of the other participants. The deceased during his life made contributions to the premium funds, and therefore his estate would have an interest in the policies on the lives of other stockholders and in cash in the premium fund in the hands of the trustee but not in the insurance on his own life.

In some cases, the fund to pay the premiums is made up of subscriptions by all parties in interest. This occurs usually in those cases in which protection of the credit position is the primary object of the business life insurance trust. Of course, the insurance does not entirely escape the Federal estate tax in such cases for, to the extent that the insured's subscription supports the insurance on his own life, the premiums

are paid directly by him, and the insurance, if payable to the corporation, is for the benefit of his estate. Therefore, insurance proceeds, to an amount which may be determined only after calculations of great nicety, must be included either as part of the corporate assets in valuing the decedent's stock or as a specific asset under the heading "Life Insurance" in the tax return for the decedent's estate.

The Beneficiary

Fellow Officers and Directors

There are no tax disadvantages in having the insurance proceeds payable to the fellow officers of the insured. The proceeds of the policies are not part of the estate of the insured except to the extent that he has made the premium payments on them during his lifetime, and they need not therefore be included as part of his estate for estate and inheritance tax purposes. Nor are the proceeds of the policies included in income by the surviving officers for the purpose of Federal income tax.

Fellow Stockholders

From an operating standpoint, this is the most satisfactory arrangement. There are no tax disadvantages. The tax situation is the same as in the case of insurance payable to the fellow officers of the insured.

The Corporation

The only effect on Federal estate and inheritance taxes produced by having the insurance paid to the

corporation is that the face amount of the policies must be included in the corporation's assets when the value of the stock holdings of the insured is arrived at. The proceeds of the policies are not income to the corporation for the purpose of Federal income tax, however. (*U. S. v. Supplee Biddle Hardware Co., 265 U. S. 189* [*1924*].)

Duration of the Agreement

In Pennsylvania, Massachusetts, New Jersey and most states of the Union, where the old rule against perpetuities is in force, the problem is quite simple as the agreement can be drawn to continue "during a life or lives in being and twenty-one years thereafter." All the parties to the agreement, or those who are apt to become parties to the agreement, are living at the time the agreement is put in force and the only precaution which must be taken is to make sure that the language of the agreement is not so broad as to permit the admission of persons then unborn as parties to the agreement at a later date. This is a question of draftsmanship and does not present a real obstacle to the setting up of the arrangement.

In New York, the rule fixing the limits of time during which funds may be tied up has been arbitrarily fixed at two lives in being. In New York, therefore, the duration of the agreement must be strictly held within the limits of this rule. This may be done in two ways: The duration of the agreement may be limited on the lives of two specified individuals, with the implied understanding that, when the agreement terminates by the death of the latter of the two of them.

a new agreement for a further period to the extent permitted by the statute will be entered into by the survivors. The alternative would be to limit the duration of the agreement until the death of the second of all the parties to the agreement on the same implied understanding that the survivors would renew the agreement and its operation on the same, or generally similar, terms for the further period permitted by the statute.

In cases in which the power of revocation of all parties to the agreement is extensive, the arrangement may be considered a mere agency and the Rule Against Perpetuities and Against the Suspension of the Power of Alienation may be largely ignored. (*Equitable Trust Company of New York v. Pratt, 117 N Y. Misc. 708 [1922], 193 N. Y. Supp. 152, affirmed without opinion 206 N.Y. App. Div. 689 [1923].*)

Care also must be taken that the voting power of the stock is not suspended longer than the period during which voting trusts are permitted under the law of the state in which the agreement is to be carried out. In New York State this limit is ten years (*N. Y. Stock Corporation Law, Sec. 50*).

Furthermore, difficulty in dealing with the insurance companies might be encountered if the agreement were irrevocable in character. If in adjusting the rights of the parties at any time it should become important for the trustee to avail itself of the loan and cash surrender values of the policies, the insurance companies might question the right of the trustee to take this action in view of the irrevocable character of the trust

even though the agreement contained specific provision to that end.

Assignment

There remains to consider the status of the parties to a business insurance trust where their rights arise as the result of an assignment by the insured. "The authorities are agreed that an assignment of a life insurance policy to a person possessing an insurable interest in the life of the insured is valid." (*37 C. J. 387, Life Insurance.*) Where, however, the policy is applied for by a person having an insurable interest with the intent and purpose of assigning it to one having no insurable interest, both the policy and the assignment are void. Thus it is dangerous practice to carry out a business life insurance trust by having an assignment of insurance in large amount on the life of a stockholder applied for by the stockholder in the first instance and by him assigned to the corporation which thereafter pays the premiums according to previous arrangement. In the majority of states, if the insurable interest was present when the application was made and the assignment is bona fide, it will be sustained notwithstanding absence of insurable interest on the part of the assignee. (See *37 C. J. 387, Life Insurance, supra* and *3 L.R.A.N.S. 935.*)

It is frequently desirable to put the business life insurance trust into effect by utilizing outstanding insurance, in whole or in part, and the method of making it subject to the terms of the agreement is by assignment. Unless insurable interest on the part of the assignee is lacking, there can be no objection to this

course. It should not be forgotten, however, that the use of an assignment may cause tax complications that would otherwise be avoided. For instance, if A who has a $50,000 policy of insurance on his life enters into a business life insurance trust and deposits the $50,000 policy with the trustee, there is always an opportunity for the field agent of the estate tax division to question the assignment as a transfer made in contemplation of death or intended to take effect in possession or enjoyment at or after death.

The Federal income tax also offers possibilities for confusion and complications. *The Act of 1928, Section 22,* provides: "(b) Exclusions from gross income.—The following items shall not be included in gross income and shall be exempt from taxation under this title: (1) Life Insurance.—Amounts received under a life insurance contract paid by reason of the death of the insured . . . . (2) . . . In the case of a transfer for a valuable consideration, by assignment or otherwise, of a life insurance . . . contract, or any interest therein, only the actual value of such consideration and the amount of the premiums and other sums subsequently paid by the transferee shall be exempt from taxation." It is not maintained that the use of an assignment would bring the proceeds of the policy within the language of the Act and thus render the proceeds in the hands of the trustee subject to Federal income tax. It is merely intended to point out that by use of an assignment, the transaction may appear to fall within the Act to such an extent as to warrant and require a full and searching investigation on the part of the tax authorities. This is always troublesome

and tedious for the trustee and the parties in interest. The same result can be accomplished by direct application for new insurance, with the added advantage not only of avoiding tax liability, but also any suggestion of it in the transaction, thereby saving the trouble and expense of investigation by the tax authorities.

PART IV

SALES

CHAPTER XIV

FINDING AND DEVELOPING PROSPECTS

There are four great advantages in negotiating and selling a business life insurance trust. These are:

1. The fact that a man's business is generally the first thing in his thoughts, so that he is particularly receptive to any idea which may improve or safeguard his business. Granted that he is in business largely for the sake of his family, nevertheless the approach through business interest to more personal interest is normal and natural.

2. The fact that the appeal is businesslike rather than of a sentimental nature. The approach to the subject is thus made more easily and naturally in the prospect's place of business, and fits into the atmosphere of his regular business dealings.

3. The fact that a man's business interests are more publicly known and discussed than he would consider proper in the case of his family affairs and interests.

4. The fact that the life underwriter and the trust officer work together and thus exert a much stronger influence in favor of a sale than they could if working separately. The matter of coöperation between the trust officer and the life underwriter will be treated more particularly in Part IV, Chapter XVII.

Finding Prospects

Almost all men are anxious to provide generously for their families and to insure the protection of their dependents. Heads of families think seriously about arranging their estates in order to leave their affairs in good order at the time of their deaths or in anticipation of retirement. There is probably no other duty of like importance about which men so universally procrastinate, however, as in the making of wills or in the planning of their estate affairs. One reason for this, no doubt, is a natural dislike of discussing matters of an entirely personal nature with comparative strangers.

This reluctance is not met with to any degree in presenting the business life insurance trust, for men in general are ready and glad to discuss anything pertaining to their business interests. Any plan designed to offer a practical solution to problems connected with his concern, and which is presented in a straightforward manner, is sure to receive attention from the intelligent business man. There is a great advantage in presenting the business life insurance trust, for it is a new and concrete program which solves the real and hitherto troublesome problem of disposing of business interests after death, by means of a purchase and sale agreement.

Another favorable feature is that the discussion of a business life insurance trust does not turn entirely on the death of the prospect himself but involves the certainty that some one of the group may die unexpectedly or at a critical moment. Many men will

think about the possibility of the death of their associates although they do not like to contemplate and discuss their own early deaths.

Sources of Prospects and Information About Them

The business field is wide and at present fertile for cultivation, because of the comparative youth of the business life insurance trust plan. This new field should attract the attention of every ambitious life underwriter. A valuable fund of information about business concerns is available in public records. A few of the best sources of reliable information are outlined here.

1. *Commercial Reports.*—The familiar volumes of commercial ratings furnish an almost inexhaustible list of good prospects, giving their financial standing. If a concern is selected because of its financial rating and if it includes a number of individuals who may be considered in the business trust program, a detailed and up-to-date financial report of its affairs will be found exceedingly helpful. If the case is not very complicated, the last annual financial statement may be sufficient as a basis of procedure. Such annual balance sheets are now published widely and can be secured in almost all parts of the United States in business and financial periodicals. Frequently, these statements show, under assets, the cash value of business life insurance carried for the firm or corporation. This item has several uses for approach purposes: to learn whether the life insurance is up-to-date and adequate, and whether the question of a life insurance trust or of an agreement

for the disposal of the different interests has been properly considered. If the life insurance shown in the statement has been properly followed up, it may well be that adequate service is being rendered and that a new approach will not lead very far. Conditions and circumstances in the business world change very rapidly, however. In many cases, the insurance protection is insufficient and new and better methods of adjusting the affairs of the concern have not been brought to the attention of firms and corporations carrying life insurance.

The financial statement may be used also for the purpose of approaching neighboring or competing firms and corporations. The published statement of an adequately insured shoe manufacturing company may be the means of introducing the subject to other and perhaps smaller corporations or partnerships who know and respect the larger and insured organization. The field man may take the position that business life insurance has become so indispensable for all types of business that the concern which does not use it should explain and justify the omission. Successful approaches using this information as an incomplete record of the corporation's position have frequently been made. When the statement of the corporation shows no insurance cash assets on its published balance sheet, the president or treasurer should be approached with the suggestion that their concern must carry business life insurance, and that his concern does not do itself full justice unless the item of insurance is shown in the published statement.

If a special commercial report from a mercantile

agency is used, great care should be taken to analyze it so that it may be discussed to the best advantage. A thorough knowledge of the figures will frequently bring out a hidden need for business life insurance which a superficial reading might never reveal.

2. *Corporation Reports.*—The annual corporation reports filed with the proper department of the state in which the corporation is incorporated or operating should be analyzed and used in the same way. If the treasurer or any other officer who understands bookkeeping is to be approached, the field man must learn to talk in his terms, and to know whether the balance sheet in question shows a profitable or an unprofitable year. The life underwriter who does not know the credit from the debit side of such a statement had better not use it in his solicitation. Concerns which show a good surplus are of course to be preferred. If the case is worth going after, it will pay to master the statement and to use special items in support of the approach. Such familiarity with the corporation's financial status, accompanied by discreet praise of its strong points will go far to guarantee a successful approach and interest in what the life underwriter has to suggest.

As an illustration of the character, value and extent of these statements the following, selected at random, are reprinted from an issue of the *Banker and Tradesman* of Boston (April 26, 1930). In this connection it may be noted that several times as many corporation statements appearing in the *Banker and Tradesman* now show the cash value asset as compared with the published statements of five years ago.

ADASKIN FURNITURE CO. (Mass) Fall River Edward Adaskin, Tr Dec 31, '29, Mar 27, '30

Real est	$ 8,675	Capital	$100 000
Merch	65,478	Mtgs	5,000
Furn, fixt, tools	16,548	Accts pay	26 670
Vehicles	5,839	Notes pay	89,841
Notes rec	3,471	Accts rec	21,099
Accts rec	264,995	Res for depr	12,780
Cash	10,804	Surplus	124,231
Def	3,327	1,250 shs no par val	
Life ins pol	1,375	Divs pay	891
Total	$380,512	Total	$380,512

ALDEN SPEARE'S SONS CO. (Mass) Cambridge. E. Ray Speare, Tr Dec 31, '29; Mar 27, '30.

Real est	$157,077	Capital	$375,000
Mchy	4,847	Accts pay	150,096
Merch	125,893	Notes pay	120,000
Furn, fixt, tools	4,679	Reserves	4,747
Vehicles	11,046	Surplus	123,487
Notes rec	8,479		
Accts rec	265,425		
Cash	67,822		
Securities	82,982		
Life ins prems	45,079		
Good will	1		
Total	$773,330	Total	$773,330

BOYD TEXTILE CORP. (Mass) Williamstown Albert L. Stirn, Tr. Nov. 30, '29; Mar. 21, '30.

Real est	$461,748	Advs	$443,731
Mchy	398,848	Accts pay	14,123
Merch	581,484	Notes pay	500,000
Furn, fixt, tools	8,417	Reserves	101,952
Cash	17,663	25,500 shs no par val	926,974
Prepd exp	8,535		
Prepd ins & int	13,187		
Cash val officers ins	24,211		
Pat rts	15,000		
P & L	457,687		
Total	$1,986,780	Total	$1,986,780

NEISNER BROTHERS, INC. (N Y) Boston & Worcester. J M. Neisner, Tr. Dec. 31, '29, Mar 10, '30

Merch	$2,250,800	Capital	$2,208,700
Cash	794,340	Accts pay	266 399
Accts rec	89,563	Res for taxes & ins	146,792
Securities	1,133,686	Surplus	2,533,097
Def	171,762	Shs no par val	810,045
Life ins	24,801		
Furn, fixt	1,500,081		
Total	$5,965,033	Total	$5,965,033

GEM CRIB & CRADLE CO. (Mass) Gardner Wilford P. Shuffleton, Tr Dec. 31, '29, Mar. 28, '30.

Real est	$84,963	Capital	$138,400
Mchy	62,861	Accts pay	17,806
Merch	78,795	Notes pay	25,000
Furn, fixt, tools	3,314	Reserves	62,763
Vehicles	2,315	Surplus	95,570
Notes rec	873		
Accts rec	77,113		
Cash	9,867		
Securities	2,200		
Def chgs	2,318		
Cash val life ins	2,920		
Good will	12,000		
Total	$339,539	Total	$339,539

GEORGE BAKER & SONS, INC. (Mass) Brockton. Edward C. Baker, Tr. Dec. 31, '29; Mar. 27, '30

Real est	$150,662	Capital	$132,050
Mchy	71,151	Mtgs	66,000
Merch	69,217	Accts pay	11,228
Furn, fixt, tools	7,625	Notes pay	15,000
Advs to officers	3,152	Reserves	61,142
Notes rec	2,500	Accrued items	1,493
Accts rec	13,193	Surplus	87,631
Cash	11,872		
Def chgs	894		
Prepd items	806		
Cash val life ins	1,804		
Patents, etc.	41,668		
Total	$374,544	Total	$374,544

NEW ENGLAND WOOD PRESERVING CO. (N. H.) Boston. J. D. Counahan, Tr Dec. 31, '29, Mar. 17, '30.

Real est, vehicles, mchy, tools, sup & equipt	$342,163	Capital	$215,500
Merch	226,489	Inter co	172,738
Cash	49,194	Accts pay	24,797
Accts rec	120,132	Notes pay	70,000
Notes rec	750	Reserves	20,625
Def chgs	5,269	Surplus	275,268
Cash val life ins	15,798		
Intangibles	19,133		
Total	$778,928	Total	$778,928

HADLEY FURNITURE CO. (Mass.) Worcester. A. J. Levi, Tr. Dec. 31, '29, Mar. 27, '30.

Merch	$67,169	Capital	$200,000
Furn, fixt, tools & vehicles	2,514	Accts pay	18,159
Accts rec	312,169	Un gr profit	165,819
Cash	24,511	Surplus	50,719
Prepd exp	840		
Life ins	22,899		
Miscel rec	4,595		
Total	$434,697	Total	$434,697

3. *New Corporations.*—New corporations are being organized constantly in considerable numbers and the list of these is of importance second only to that of companies already operating with success. These lists are usually available weekly or monthly in local newspapers. If they have to be sought in the public records they are all the more valuable, for there are not many underwriters sufficiently painstaking to follow these names regularly and the competition from other underwriters, once a good name is discovered, is not very keen. But many of

these are untried and insubstantial, and the wheat must be separated from the chaff. Little time should be spent on those which are not worth while. Those which are strong and depend upon strategic executives should be urged to start right by arranging for insurance protection at the outset.

4. *Directories of Directors.*—A directory of directors is invaluable in the selection of business insurance trust prospects. There are several hundred new directors, many of them growing young business men, whose names appear for the first time each year in such a list. The advantage of this list is that the co-directors' names are available. Also, many partners in successful firms are listed, with a showing of the corporations with which they are connected. It frequently develops that, of the group with which they have some active business connection, one enterprise at least has proved the value of business life insurance, making it an easy matter to approach other concerns with which they are identified.

The endless chain method of prospecting is specially good for these reasons in business life insurance trust solicitation. If the life underwriter, with the help of the trust officer, does a thoroughly good job in each case, he will not be at a loss whom next to see or how to make the contact naturally.

Advertising men have frequently stated that the officers of large corporations invest their money in advertising much more readily than individuals or partnerships transacting a business of equal volume. The same thing is largely true of life insurance. The individuals involved are more numerous and it is more

natural to anticipate changes due to death. There is a community of interest in the group which may well make the placing of a proper business life insurance trust easier than the selling of an individual life insurance trust. Unfortunately, however, the reverse of this is also true, because one objector will frequently make it difficult to carry through the arrangement even when the majority favor it.

The great vogue of business life insurance among many corporations; the notable cases in which it has played a leading part in the prosperity of the enterprise (for example, John Wanamaker, Philadelphia, and Saks & Company, New York); and the fact that the life insurance trust is not only new but also in line with the financial developments of the time and the country, are all of special value in the approach. It must be remembered and frequently emphasized, that the business life insurance trust is a financial plan fully as important in its field as are investment advice, life insurance to meet inheritance taxes, or the corporate executor and trustee in arranging one's personal affairs. Thus, the man presenting this subject is in line with the march of modern financial and business progress. He must not hesitate to emphasize that leadership at every opportunity.

Whom to Approach

The question of whom to approach is often a difficult one. Many important business men are modest about their value to their enterprises and each will insist that his business is so organized that it will go on successfully in case of his death. This is a fre-

quent obstacle particularly where *shock* insurance is under consideration. Let us admit that most of these men are sincere in this expression of unnecessary modesty. Other influential men in the company may be approached directly and found ready to advocate or at least support the proposal that the principal be insured for a generous amount. It is, of course, desirable for the field man to ascertain by careful and tactful inquiry the worth of the principal to the business and close the sale by having those associated with him in the business confirm that worth.

Often the approach should be made through stockholders who are not sought to be insured and who may not be active in the management. In other cases, a minority stockholder or a junior partner may furnish the impetus and arrange for the matter to be discussed by those men in the organization who must decide it. Frequently the tentative assent of the men to be insured can be secured if the underwriter obtains an opportunity to present the matter to the directors, either individually, or at a directors' meeting. In the case of a partnership, a special partner or a financial backer may be the proper person to talk with in the first instance. Probably there is no phase of the approach to business life insurance trust which requires more care and tact than this matter of introducing the subject to the right people at the right time. Cases have been known in which a tentative consent had to be secured from every director, each one in turn declining to commit himself in advance. There were none actually opposed to the proposal, but none willing to advocate it. Finally, they dis-

covered that each director realized the importance of adequate life insurance on the principal lives in the organization. After this point was reached, the right sort of salesmanship won the common consent of the whole board.

Selling Technique Important

It is assumed that the life underwriter is experienced in the technique of pre-approach, approach and awakening interest in the mind of the prospect, thus leading up to the presentation and consideration of his proposal. Those of less experience should make a careful study of the technique of life insurance salesmanship before entering this field.

Such technique includes the use of letters before seeking a personal interview, the use of the fine supply of printed matter and forms which are available in this field, and all the other points of approved salesmanship which are now available in the education of the life underwriter.

Forms of Approach

The business life insurance trust field is rich in approach material and methods, of which the most successful may be listed:

The Bank Credit Form Approach.—Many Federal Reserve and other banks recognize the importance of business life insurance, and their forms may be acquired and used in many cases, particularly as to life insurance for *credit.*

The Annual Statement Approach.—This has already been explained and, properly used, is a most

effective method. The regularity with which new statements appear make the information necessary for this approach easily available.

The Tax Approach.—No business life insurance trust case is properly handled unless the tax phases are fully considered, but the tax approach should be used in a very small number of cases. The only way in which the subject of taxes can be used as an approach is to offer a plan that will save taxes. This, as a rule, is injudicious for several reasons. Tax dodging is morally indefensible. Tax saving is difficult and what may be a sound plan for saving to-day may be upset by a new law or decision to-morrow. Protection is the feature to emphasize. One should be familiar with the different taxes, particularly inheritance taxes and how they operate, but should subordinate discussion of them to the main purpose of all life insurance programs—protection.

The Will Approach—This is one of the most successful methods. Every partner in a firm, every stockholder in a close corporation regards sympathetically an arrangement which assures the continuance of the business after his death. He would be glad to have his associates continue and prosper if he were gone; but it isn't vital to him to make such an arrangement. He wants to safeguard himself against the disadvantageous result of the death of one of his associates, and the possible complications of such an occurrence are impressive; but after all, his most vital interests are his wife and children and a most effective presentation of the business life insurance trust is to show that it is of untold advantage to them.

"How do you propose to dispose of your interest in this business so that your family will get the full benefit of the money, the thought and the effort you have put into it?" is a question that arrests attention. The underwriter may assume that each man has made some provision in his will on the subject but most wills do not safeguard business interests. The underwriter should then address himself to showing that the business life insurance trust is a better plan. Do not condemn what the man has done. Commend it, but show that there is a better way, the business life insurance trust. As its advantages unfold, the weaknesses of the prospect's own plan will soon become apparent to him. Let him convince himself that his own arrangements are insufficient and unsatisfactory. Do not denounce or ridicule them directly. To do so is to create antagonism and sales resistance. Indirect selling from this approach is more likely to result in success.

The will approach is useful in dealing with a group of prospects because it enables the underwriter to talk to the group in the terms of each man's own individual family problem.

The Valuation or Good Will Approach.—"What value is to be placed on the good will of your business in liquidating a partner's (or stockholder's) interest?" This is a question that is sure to arouse interest. Perhaps the subject has never been considered. It may have been sidetracked. The principals may even have agreed that good will is an asset that does not have to be given a value.

In many concerns "good will" has a definite asset value. Among firms, members of New York Stock

Exchange and other security exchanges, it is of real moment. For inheritance tax purposes, good will must be given a value, see *Prentice-Hall Inheritance Tax Service* ¶ *23154*. It is good practice for the underwriter to familiarize himself with a few concrete cases from such sources and to show the methods used in fixing the value of "good will" in cases involving well-known concerns. These are always of interest to successful business men. The underwriter should be able to present a simple valuation formula, involving assets, surplus and earnings, and to lead from the discussion of good will to the all-important question of the proper value to be placed upon the holdings of a decedent partner or stockholder. Then follows naturally the purchase and sale of the interest at such value.

Every successful field man, whether a life underwriter or a trust officer, should have his own concrete and interesting outline of what happens when death invades the enterprise, and should be prepared to cite interesting and illustrative cases of the use of the business life insurance trust for the settlement of these problems.

CHAPTER XV

PREPARATION AND PRESENTATION OF BUSINESS LIFE INSURANCE TRUST PROGRAM

It is almost impossible to say where the approach ends and the presentation of a proposed plan of action begins; but generally speaking, it may be said to come at the point when the prospect's interest has been stimulated so that he consents to have the solicitor explain what he has to offer.

General Methods of Presentation

Having obtained the opportunity to explain his proposal, the trained salesman must decide, sometimes on the spur of the moment, which one of several methods he will employ:

1. The scientific or analytical method, by which the salient points of the case are fully discussed first, and the routine administrative phases touched on briefly or left for a later interview;
2. The chronological or legal method, by which all data and documents bearing upon the case are introduced in regular order;
3. The selection of an outstanding feature of interest in the particular case, building upon a favorable reaction to this in the hope that success will follow;
4. The haphazard verbal method which trusts to

knowledge of the subject, luck and experience in selling to reach a favorable result.

The last three are merely parts of, or a rearrangement of, the points presented in the first, which consists of the establishment of these propositions: (*a*) that a definite arrangement should be made, in advance of death, for the transfer of an individual's ownership in a business enterprise, whether the business is conducted in the form of a sole proprietorship, a partnership, or a close corporation; (*b*) that this matter has been generally overlooked as a business necessity until the last few years, and is still very generally neglected; (*c*) that such old-fashioned methods as have been adopted in a minority of cases are very inadequate to accomplish the desired result; (*d*) that it is desirable for the most part to keep ownership in such enterprises associated with management, certainly up to the point of having management in control; (*e*) that a purchase and sale agreement adapted to the particular case is of prime necessity in adjusting ownership at time of death or retirement; (*f*) that the modern financial and business advantages of a life insurance trust must be used to consummate the arrangement and make it 100 per cent effective.

Simplifying the Proposal

This is the outline which should cover the case in order to arrange a business life insurance trust for the transfer of the interest of a partnership or corporation of a decedent principal owner. This outline would make the subject seem a complex one, if

presented in this form, to the average business man. Of course, it is rather complex and when concluded is set out in a rather formidable legal document, but the life underwriter's interest in the outline, when he is attempting to make a sale, is simply to show the prospect or prospects *what it will do*. He and the trust officer who coöperates with him must be able to demonstrate the advantages of the plan in simple, persuasive business English. It is assumed that he has the sales ability and technique which will enable him to select and present, in simple and brief form, whichever outstanding advantage of this plan is most likely to interest his hearers. Thus he will use the points of the suggested analysis somewhat as follows:

1. What, if any, method have you already in force to accomplish the desired result?

2. Some method is necessary. If there is no method at all, the case is half won. If some plan is already in force, this method shows that some consideration has been given the subject but that it could be improved. A more comprehensive plan would show much better results. One must be sure that both method and life insurance are adequate.

3. The advantages of a purchase and sale agreement for the retirement of the interests of decedent members are: (stating them).

4. Forms of purchase and sale agreement show what has been done by other concerns.

5. The life insurance trust assures the fulfillment of the program.

This may all be done verbally, with written or printed illustrations and forms as needed. Most pros-

pects will ask the salesman to write out the entire proposal and leave it for consideration, and this has sometimes to be done. Where the salesman is allowed to explain matters and select his own method of presentation, one of the best plans is to have a definite outline, based upon the general analysis of the whole subject, modified to conform to the facts of the particular case, and he should adhere to that outline in his presentation.

The life underwriter who specializes in this field should make his own analysis, with proper headings and subdivisions, and master it so thoroughly that he cannot be disturbed, thrown off the track, or prevented from making a clear presentation of his main points, no matter how many questions, objections or other diversions occur. He must be master not only of his subject, but also of its attractive as well as logical presentation; and such preparation, amounting to saturation in the subject, will enable him to dominate most of his interviews.

Outline of Presentation

An effective way to do this is to have a brief outline typewritten upon a card, with a copy for each prospect present at the interview, and to insist, so far as possible, that the subject be taken up as outlined, each point being fully considered before passing on to the next. The typewritten outline not only assists the salesman in holding to his program and in presenting it, but it shows the prospect that much care and painstaking study has been expended upon his particular problem.

The outline should follow the points indicated and should be kept within the smallest possible compass. It should be expressed in the simplest and most direct business terms, easily understood by men in the particular field in which the enterprise is operating. The use of similes adapted from the prospect's own business is very persuasive.

Just as an able trial lawyer handles his case on one definite theory which he thinks will appeal to judge and jury, so a salesman of a business life insurance trust must select his theory for each case with the greatest care, and then stand by it and present it with the greatest fidelity. If unsuccessful in the theory adopted and presented, he will undoubtedly have the advantage of returning, perhaps after a year or two, with another and better theory.

It seems needless to remark that the outline and presentation should be cast in terms of what can be accomplished for the prospects, rather than in terms of the machinery and forms which must be used.

Use of the "Ledger Statement"

The "ledger statement" form of proposal may be used in any of the plans of presentation outlined and has proved successful in the hands of many large producers of life insurance. It brings the whole subject, and particularly the matter of cost, before the prospects in a businesslike, clean-cut way which is apt to attract immediate and favorable attention. The most successful form of ledger statement or balance sheet shows probable net premiums in one column,

surrender values in another, net cost if surrendered in another, and in a final column, results if carried through until the policies become claims or mature as endowments. It makes a more definite impression than the old-fashioned form of ledger statement, which is made up as of a given date when the policyholder, having survived, surrenders the policies for cash. The latter plan shows a very small net cost during the time the insurance is in force, but it has the disadvantage of indirectly suggesting surrender. This may be counteracted by emphasizing the point that the assumed date of surrender is used only to show how low the cost is.

Other ways of doing this are to accelerate the policies and estimate their maturity as endowments, which shows the figures of the net cost in a definite way, or to take ordinary life policies not accelerated and assume death to occur according to the mortality tables. An occasional death claim may be inserted at the proper point. All of these forms are perfectly legitimate if honestly made in accordance with all the known and probable facts. If a ledger statement is made assuming survival and surrender at the end of ten years, good salesmanship may lead the prospect to say that if the insurance had been carried that long it should not be allowed to lapse but should be kept in force. It is easy to show that at the end of ten years the hazard is greater, the rate is higher, and the cost of the policy taken ten years earlier is continually decreasing. Almost any prospect will admit some strength in the argument that, if a policy would be so good at the end of ten years that he would not

think of dropping it, he is making no mistake in purchasing it at present.

In the case of a strong business concern, figures and arguments can be made on the theory that such an organization has the ability to carry through to the end. Temporary advantages are less important in such cases, and the certain results to be had by carrying on to the end can be stressed. In the case of investment bankers of good standing, for example, the constantly improving nature of the insurance sinking fund will incline them to carry right through if they once start, and the better showing if the policies are carried through to maturity will probably have more weight than a balance sheet made up to show the result of a few years' operation only.

Calling In Business Insurance Specialist

If a life underwriter has not had the opportunity to study business life insurance and insurance trust problems, he should nevertheless be able to give his regular policyholders a complete service when they need it. This can often be done to best advantage by calling in a more experienced underwriter; perhaps one who makes a specialty of these large insurance problems and who devotes study to keeping up with their rapid development. It is a mistake simply to frame up a presentation with the help of a trust officer, general agent or specialist, with the idea that with such preparation the uninformed agent can successfully carry through the negotiations. He may have a perfect outline and start off well, but innumerable questions will arise before the matter is decided, and

he may become confused. Many such cases have been lost or spoiled because the younger or less experienced agent does not appreciate that he would make more progress and larger commissions in the long run by associating himself with a specialist, and dividing commissions with him. In the latter way he will close a larger percentage of his cases and for larger amounts.

To Whom Proposal Shall Be Made

A matter mentioned in the preceding chapter becomes of great importance in making the presentation; that is, to decide whether the leading member, the junior, the principal financial backers, or the less active directors are to be interviewed and convinced in the first instance. This might be called the personal theory of handling the case and it must be developed as carefully as the presentation itself. If the salesman has built up a relation of personal confidence with one or more of the individual members, frequently he can discuss the important matter confidentially with them and thus start with a strong advantage.

Closely allied with the matter of choosing the individual or group to whom the presentation shall be made is that of deciding whether it is wise to assemble a meeting of a large committee, or of the entire firm, or the board of directors. Such a meeting is, of course, effective only if a few of the more influential members can be relied on. It is also vital to know whether the group contains one or more strong opponents, or members who have not committed themselves but who are naturally opposed to new and untried arrangements. One strong objector can often block action

which a number of his associates favor, and at best he can probably postpone action. In such cases it is best to deal with the officers and let them handle the directors. All this is part of the development of the personal theory to be adopted in the particular case.

The salesman who has closed cases, or who has contacts with trust officers or a general agent familiar with such cases, can often use actual forms of proposals and even of contracts with the names deleted. Although it is usually not proper to discuss the names of policyholders, those who carry business life insurance are as a rule not so sensitive about being quoted as are many large policyholders whose insurance is for the benefit of their families. Agents should remember that while they may be in touch with a large amount of "insurance in force," each unit is personal and should be treated as confidential without express consent to the contrary. If the business insurance is carried for credit purposes, the bank or other creditor knows of it, and, since the whole matter is a business affair, trust officers and life underwriters are frequently allowed to quote the general features of such a case. It seems good policy, whenever a life underwriter quotes the life insurance of any policyholder to a prospect, to state that he does so by express permission; otherwise the prospect may reach the conclusion that any business he might do with that underwriter will soon become a matter of general conversation and gossip. Whether names are to be quoted or not, if a form may be shown with the statement that it has been used in the case of a successful firm or

corporation in the same locality, it will carry added weight.

The Lord Baltimore Hotel Case

Notable cases for purposes of illustration have been comparatively rare because business life insurance trusts are comparatively new, but such illustrations will be increasingly available as some of the trusts already arranged become operative. Early in 1930 the Baltimore newspapers reported the death of Harry Busick, the president of the Lord Baltimore Hotel Company of Baltimore. Two years previously he had been insured for $1,150,000 to protect the preferred stockholders of his company. In accordance with the terms of the trust, the proceeds retired the preferred stock of that amount and increased the value of the common stock accordingly, thus accomplishing a double purpose. In this case, the investment bankers stressed the life insurance trust in their prospectus. Similar circulars issued by security dealers are often obtainable and are of value for purposes of illustration.

Investment Bankers

Investment bankers and other financial houses have sometimes been slow to create business life insurance trusts, or even to carry business life insurance, because they felt that they had at all times the goods on their shelves, so to speak, with which to retire the interests of decedents. Formerly a settlement "in kind" was generally adopted by financial houses, with a considerable period allowed for survivors to settle with

the estate of the decedent member. Besides other disadvantages of such a course, three developments of the last ten years favor a plan to bring in cash from the outside with which to make, or assist in making, the necessary settlement.

1. Inheritance taxes require large amounts of cash which must be paid to the Federal Government and the state of residence within one year after the estate is created.

2. Most estates are now left largely in trust, and they can function to better advantage if the securities turned over to them are to a large extent in "trustee's securities" rather than "business men's risks."

3. Investment banking has come to deal more and more in common stocks, preferred stocks, convertible bonds and classes of industrial and other securities which are better for the survivors than for trustees or beneficiaries. Thus a purchase and sale arrangement, rather than setting off to the decedent his share in the assets, is of mutual advantage.

When One Member Is Uninsurable

The case of the uninsurable member must of course arise from time to time, and may easily produce an awkward situation. Going back to our analysis, let us remember that our method of retiring the interests of decedent members is thoroughly sound and proceeds up to and including the desirability of a proper purchase and sale agreement. That proposition is fundamental; that is, the interests should be sold and bought and not sacrificed or lost. Having settled the matter that a sale ought to be made and having de-

cided who must sell and who ought to buy, the only question remaining is how to supply the wherewithal at the right time and at the right price. We consider the life insurance treasury the best bank to supply the funds when, how and as needed. However, if the life insurance trust cannot be used for one member because he is uninsurable, a sinking fund should be created to cover his case, and additional time should probably be allowed to the purchasers by his representatives or beneficiaries.

In other words, if the life insurance method cannot be used, allowance must be made therefor and the next best means adopted. The whole transaction need not be abandoned. The fact that the plan has to be varied because of this peculiarity is an incident affecting that one interest and not the whole proposition. If no provision is made, the asset of that member of the concern will be frozen. The life insurance trust will make it liquid. The sinking fund for the one who is uninsurable and life insurance for those who are insurable reduce to a minimum the demands on the business for prompt liquidation.

In preparing the plan as well as in presenting it, the vital thing to remember is that the prospects must be made to visualize what will happen when one of them unexpectedly dies. Whether he is a sole proprietor, a partner, or an important stockholder in a close corporation, if he (or an associate) should drop out of the picture to-morrow, or next month, or next year, what will be the situation from the viewpoint of his associates and his estate? What is the best arrangement that can be made in advance, in order that the

business may go right on and in order that his estate and its beneficiaries may be sure of a perfectly square deal?

Sometimes it is difficult to persuade hard-headed business men, full of life, energy and prosperity, to sit down and visualize the new order which will arise under those circumstances. If, however, they can be led to do it in a simple and natural way, knowing that the underwriter and the trust officer have no thought of advising anything but what they themselves would do under similar circumstances, the business life insurance trust can sooner or later be put through on its merits with a large majority of successful business organizations.

CHAPTER XVI

OBSTACLES AND HOW TO SURMOUNT THEM

The path to any goal worthy of attainment is strewn with obstacles. Some bulk large in the middle of the road, others are small, and off to one side or the other. Like all other negotiations which seek to bring about specific action on the part of the prospect, the attempt to place a business life insurance trust is sure to develop doubts and complications while discussion of the subject is in progress. The purpose of this chapter is to deal with those which seem to arise most frequently in actual practice and to suggest methods by which they may be met and overcome. Some obstacles must be surmounted, others passed by, either by a complete change of direction or a slight deviation from the course.

Making Assets of Obstacles

Another bit of homely philosophy may be remembered when an obstacle is presented: Many an obstacle may be made an aid to progress instead of an obstruction, if the underwriter is active and aggressive in his make-up and not easily dismayed by the unexpected. A common illustration of this, in the field of life insurance salesmanship, is the part which the necessary medical examination plays in the case. It

may easily be made a liability—that is, an obstacle which it is hard to surmount; but in the hands of the trained and successful agent it becomes a very distinct asset by means of which the prospect's natural pride in his own physical condition furnishes an incentive to the sale, and does not constitute a deterrent to it.

There are two general obstacles and a larger number of specific difficulties which may be briefly discussed with suggestions that may assist in finding the right method for meeting and overcoming these and other types of opposition.

The general obstacles which impede the sale of a business life insurance trust are (1) the matter is a complicated one, and (2) it has to be sold to a number of prospects.

In trying to negotiate a necessarily complicated transaction, it is all-important to fasten attention upon the main object to be gained by its completion, and to leave details to be filled in later. The main points of the case must be gone over again and again, with different presentations, approached from different angles, emphasized with convincing illustrations, until the prospects have become saturated with the fundamental objects of business life insurance. No discussion of details or secondary matters should be allowed. Defer consideration of them. They will cloud the issue.

Many a complicated negotiation has been thwarted by the type of mind which insists on putting necessary but uninteresting details into the foreground of the discussion. When the time comes to attend to the de-

tails, those which should prove most interesting to the prospects should be discussed first. Thus, and thus only, may the whole case be viewed in proper perspective.

No one can claim that a business life insurance trust is a simple proposition, but the end in view and the principles involved can be stated clearly and simply. The ability to do that and to handle details properly is the mark of a successful life underwriter or trust officer.

The difficulty of dealing with a number of prospects has been treated in Part IV, Chapter XIV. This again is a necessary part of nearly every business life insurance trust. No doubt the greatest success in overcoming this obstacle is had by those who can select the one or two individuals whose leadership or whose special influence in the case will make the acceptance of the plan most probable. If negotiations have to be conducted in the presence of several individuals, as with a board of directors, for example, the skill of a trained diplomat will be required. A trial lawyer selects the man or men whom he believes to be most likely to influence the jury and addresses his remarks to him or them. The underwriter must adopt similar tactics.

Stress the Main Points

Before entering into a discussion of a business life insurance trust program, it is well to stress the main subjects with which the program deals. These are: (1) the liquidation of the stock or partnership interests in case of death; (2) the valuation of the stock

or partnership interests; (3) the life protection; (4) the sources of premium payment.

There are certain to be some objections to overcome in discussing these points. The important thing to remember is that all these matters should be settled and agreed on before passing to the less important and collateral subjects. An obstacle in the consideration of a minor detail, prematurely considered, may make the whole program seem cumbersome and difficult, whereas if it is taken up after the main points have been covered and the routine of the agreement is being arranged, it will be more easily disposed of. It is folly to bring up the question of making proper allowance for the premiums paid by the deceased for the policies on the lives of his surviving associates, before the necessity for the life insurance to liquidate the proprietary interest of the deceased has been recognized by all concerned.

The minor points of the program and agreement, that is, all those other than the four mentioned above, should be classed as routine administrative matters and dealt with as such. Many obstacles will shrink in size and importance when assigned their proper places and viewed in proper perspective.

Complications and How to Handle Them

A considerable number of specific complications arise from time to time and the effort is made in remaining paragraphs of this chapter to suggest a method of treatment for each one. The details, however, will vary greatly in different cases, and these sug-

gestions are offered for the purpose of giving one possible remedy for each difficulty rather than the best solution thereof.

Difficulty in Establishing Basis of Valuation of Stock or Interest

This matter is one of the fundamentals of the whole transaction and its treatment should be made an asset rather than a liability. If it is hard to agree on values while all are living and working together harmoniously, how much more so will it be after death intervenes? It is much easier for a man, while living, to arrange a method for valuing his interest at the time of his death than to leave it to his wife or his executor, who may have no knowledge of his business interests, yet must bargain with the surviving members of the concern.

Skepticism as to the Result of the Agreed Method for Fixing Value of Stock or Interest and as to the Receipt by the Estate of an Adequate Price

The best way to overcome this obstacle is to anticipate it. A full discussion of the different methods for valuing the decedent's interest is contained in the preceding chapters of this book. If the underwriter and trust officer are fully familiar with the different methods which may be employed, they should have little or no difficulty in finding one method which will be acceptable to all concerned. Some men are better satisfied if they themselves are to fix the valuation of the different interests from time to time, and certify

their findings to the trustee and, if so, they should be permitted to make this arrangement. It is wise, however, to point out that any valuation fixed in advance, even if only a short time in advance, is apt to be an inaccurate valuation as a result of sudden business changes. A method for determining the value when occasion requires is better than to have the value fixed by the principals themselves. At all events, it is better to adopt some plan, even if the prospects do not consider it ideal, than to have no plan at all. Patient exposition of the different methods will demonstrate that *any* plan is better than no plan, and the choice as to which plan should not be difficult. Careful and thorough presentation will satisfy the doubting Thomases.

Reluctance to Permit Stock to Leave Possession or to Enter into any Arrangement Which Will Impede the Sale of Stock or Its Use for Collateral

If the parties all agree that they want free possession and ability to borrow on their stock, then the deposit of the stock with the trust company may have to be omitted as a part of the trust agreement. Undoubtedly the deposit of the stock is a very valuable feature of a business life insurance trust and yet many trusts have been put through under which each principal retained possession of his own stock and had a right to use it in almost any way he desired, provided that he did not attempt to dispose of it without giving his associates the first chance to buy. This obstacle should not be permitted to defeat the program. The objection may have to be met by its ac-

ceptance. The trust will be better arranged if the stock is deposited but, if the principals are unwilling to deposit it, the trust should be set up anyhow. The proper protection of the interests of the different parties then rests largely in the hands of the attorney who is preparing the agreement.

One or More of the Principals Is Uninsurable

This is a very real obstacle and would seem to be most successfully handled by getting the parties to agree that a purchase and sale arrangement is important as the best means of furnishing the needed purchase price at the right time, even if life insurance cannot be provided for every individual. Theoretically, the arrangement should be made and the trust created if all of the principals are uninsurable. Fortunately, those uninsurable are usually in the minority and a sinking fund should be built up on some other plan to take the place of the life insurance, with contributions to that sinking fund in appropriate amounts, and with the same regularity as the premium payments on the life insurance on the other principals are made. A fair theory would seem to be that the estate of the uninsurable individual should allow easier terms of purchase and more time than should the estates of those who are able to qualify for life insurance.

The sinking fund which should be established to help, at least, to retire the interest of the uninsurable associate should have paid into it, as a minimum, an amount equal to the premiums which would have been paid on his insurance and appropriate terms made for

the payment of the balance, especially in case of his early death. In some cases, the other associates may be willing to create a sinking fund more rapidly, say by the payment of amounts equal to endowment premiums on his life and perhaps equal to short endowment premiums, on the theory that if obtainable they would have taken out short term endowment life insurance in his case.

If it is desired to have early examinations made, either on general principles or because of fear that all associates are not insurable, the statement may be used to advantage by the life underwriter that there are approximately 6 per cent of uninsurable, 12 per cent of substandard and 82 per cent of standard risks among the average line of prospects and that it will be well to determine *now* into which of the various classifications the different members of the group fall.

The advanced age of one of the principals, rendering the cost of insurance on his life prohibitive, or an unsatisfactory physical condition rendering him uninsurable should never prevent the establishment of the trust. If a person foresees a motor collision and cannot save himself entirely, there is every reason why he should suffer as little injury as possible. So if a firm or corporation has no business life insurance program, the mere fact that one of the members cannot avail himself of the fullest advantages of such a business life insurance arrangement should not be permitted to discourage the others from putting up their framework and building their insurance protection on it.

Cost of Full Coverage on the Life of the Principal Owning the Largest Share of the Business Is Prohibitive

This has been dealt with to some extent in Chapter X, Part III. In almost every case, at least a substantial percentage of the purchase price should be carried on this life and differences made in the terms of payment of the balance according to the circumstances of the case. Some of these cases are so one-sided that it may seem fairer all around to have the corporation or partnership pay the premiums in spite of the general advantages in favor of each of the principals carrying insurance on the lives of the others.

Where the Principals Carry Insurance on the Lives of Each Other, One of Them May Be Considerably Older Than the Others and a Serious Inequality in Premium Payments May Result

The associates who pay the higher premiums on this older life will probably not have to pay for so long. In other words, the premium rates based upon the mortality tables are absolutely fair to all concerned. If the discrepancy is too great, the amount of the insurance on the older life may be cut down accordingly and easier terms provided for a portion of the purchase price.

Failure of One of the Principals to Provide Sufficient Funds to Keep Up His Share of the Premium Payments After the Agreement Has Been in Effect for Some Time

A general provision covering this matter should be included as a necessary minor detail in the deed of

trust. Usually it is well to permit the trustee to use the automatic premium payment provisions of the policies, allowing the principal who is in arrears a six months' period of grace. If the others have advanced the necessary funds to the trustee, the reimbursement by the person in arrears should be made with interest. If the default occurs during the first three years of the agreement, the one in default should forfeit all payments made by him up to that time. If the default occurs after three years, he should be allowed credit or permitted to withdraw at a substantial discount. The agreement must be so drawn that one who defaults through mere willfulness does not share equally with those who have been faithful in their premium subscriptions but it must also provide that one who is unable to continue with the plan because of lack of means shall not be penalized too severely.

Withdrawal of One or More Principals from the Business After the Agreement Has Been in Effect for Some Time

The general principles just stated for failure to meet premium subscriptions apply to this phase, also. The most suitable provision will depend in some measure on the facts of the particular case. A principal who owns a large majority interest should not be permitted to withdraw. One with a small interest, having limited means, should be more liberally dealt with. If the requirements are too binding on all the principals, the program may be too limiting. If it is too loosely drawn, it may fail of its purpose. The underwriter should work out what he believes to be a fair plan to all con-

cerned and modify it in accordance with the wishes of the principals. Some plan should be presented. If the subject is merely brought up and the principals are asked to work out their own plan, the discussion will degenerate into a floundering uncertainty that is sure to be ruinous.

Proceeds Plus Premiums

This matter is discussed in detail in Part III, Chapter XI. The life underwriter and trust officer should have enough experience to be able to quote illustrative cases and to dispose of the matter either by making a definite recommendation or by offering two or three possible solutions. This, again, is an obstacle which can be used to help, not hinder, the sale if it is treated at the right time and in the right way.

Unwillingness to Have the Different Principals Carry the Insurance on the Lives of Their Associates and a Preference on Their Part to Have the Partnership or Corporation Pay the Premiums in Order That the Cash Surrender Values May Be Carried as a Business Asset and Show in Their Balance Sheet

This is a very real difficulty and involves the weighing of one advantage against the other. If the concern has been carrying business life insurance and paying the premiums thereon, showing the cash surrender values from year to year as an asset on its balance sheet, it certainly has a right to form a life insurance trust and continue that same practice. The advantages of having the premiums paid by individuals rather than by the business itself should be set

out, but the parties themselves have, of course, the right to decide this matter.

Modern Tendency toward Consolidation of Trust Companies

The last ten years have witnessed an amazing concentration of business and industry into a few large units. As this book goes to press, the movement to unite separate and individual banks and trust companies into a single institution or to combine them under some form of centralized management and control is at its height.

This tendency should not deter but should encourage the establishment of business life insurance trusts. In these consolidations the disadvantage to the customer most frequently pointed out is that the growth in size of the trust company means a lessening of personal interest and individual attention to the needs of the customer. This is without weight in the case of business life insurance trusts. There is no occasion for the trust department to maintain any degree of personal contact with the members of the families of the insured as long as the principals live. In fact, there is scarcely any need to keep in personal touch with the principals themselves. The important thing is the security which the trustee institution affords and the knowledge, experience and judgment in commercial matters which it can furnish in fixing the valuation of the capital interest of the insured at the time of his death. In both these particulars, a large trust company, formed by the merger and consolidation of two or even several financial institutions of which the

trust company originally selected as trustee was only one and perhaps (from the standpoint of total resources) the least important part, is better qualified to serve the interests of all concerned.

Moreover, it is a very easy matter to prevent the trusteeship from passing to another and larger trust company in case of merger and consolidation, by provision to that effect in the agreement, the parties reserving to themselves the right to select another trust company as trustee. The following clause is suggested as suitable:

> In case of the merger, consolidation, dissolution or the sale of all or substantially all of the capital assets of the trustees, the ——— Trust Company and any successor trustee shall cease to be trustee hereunder, and the participants shall have the right to appoint a successor trustee hereunder, by instrument in writing duly executed provided the institution selected as successor trustee shall at all times be a bank or trust company located in the city of ——— with capital and surplus of at least ——— million dollars.

Of course, if the principals are unable to agree on a successor trust company, the court would make the appointment, for no trust is ever allowed to fail for want of a trustee.

Use of Necessarily Technical Language in the Instrument

This is a matter easily dealt with. It can be met most easily in the presentation of the trust. A business life insurance trust agreement is a highly technical document and requires great nicety of expression but

most business men dislike legal phraseology, regarding it as unnecessary and mere ostentation The lawyer who is asked to prepare the first draft of the agreement should be requested to make use of as few legal terms as consistent with its effectiveness. "Whereas" clauses are largely a matter of legal tradition. "Now this Agreement Witnesseth" has a grandiose sound. It is unnecessary. The specimen forms of agreement presented in this book have been prepared to reduce the business life insurance trust to its fundamentals, expressed in terms that any layman can readily understand. There will be much less question in the minds of the prospects if the agreement itself is presented to them in language that is straightforward, direct, and shorn of legal phraseology. An agreement so drawn will present the program in a convincing way, so that it may be understood in all its detailed workings by any intelligent business man.

Undoubtedly, there are other difficulties which may come up and which are not directly connected with this particular phase of insurance and trusteeship. Nevertheless, it is certain that, once the value of the main idea of a business life insurance trust is acknowledged, the negotiations can be so conducted that most of these obstacles will be overcome through frank and tactful handling.

CHAPTER XVII

COMBINED EFFORT OF LIFE UNDERWRITER AND TRUST OFFICER

The fact that the life insurance trust field furnishes a common meeting ground for the life underwriter and the trust officer, who were formerly comparative strangers to each other, has been shown in a former chapter (Chapter III, Part I).

The recognition of the great advantages which accrue through their collaboration in the creation and administration of estates is now being extended into the field of business life insurance. The basis of cooperation between the life underwriter and the trust officer is broader in these cases than in almost any other class of business. The reasons for this are self-evident: (1) the protection of life values in business through life insurance is a rich and undeveloped field; (2) such protection vitally affects both business and personal interests; (3) the banks and trust companies, in extending credit and granting loans, furnish the life-blood of trade, and are in a position of authoritative influence to endorse the proposals of the life underwriter.

The negotiation of a business life insurance trust is a matter of some complexity, and is of vital importance to business interests if properly carried through.

The next five years will in all likelihood see the development of the business life insurance trust on a scale comparable to the last five years' development of the personal life insurance trust. New associates will come into firms and corporations; many sole proprietorships will become partnerships and then, in due course, corporations. The life underwriter who, with the assistance of the trust officer, is able to do justice to these cases may well rely on them for steady growth in his business and income as the years go by. A small number of growing businesses, properly handled, will occupy the underwriter's full time and attention and will yield a handsome return.

Business life insurance has sometimes been criticized by home office officials of the life insurance companies as being less permanent than personal life insurance. If placed through a well-designed life insurance trust, it should be more permanent, because, if properly written in the first place, it will pay the parties interested to carry it through to the end. There should be a succession of policyholders as the older men drop out and younger men succeed them.

The Trust Company's Relations with Depositors and Customers

The exact position of the trust companies, their relations with their own depositors and customers, and the limits to their activity in advocating and recommending the insurance protection which the underwriter has presented, are not thoroughly understood.

The prestige of the banks and trust companies of

the country rests upon the public confidence which they enjoy. This is based upon their integrity, their impartiality and the wide sphere of their influence. No bank or trust company can afford to adopt a business policy that creates the least doubt in the minds of the public as to the integrity or impartiality of the institution, for this means a serious loss of prestige.

There are certain relationships in human affairs which are of a highly confidential nature, such as those prevailing between doctor and patient, lawyer and client. The relation between a trust company and its customers is of the same general character. No one would do business with a trust company that did not guard with absolute fidelity the information which comes through the handling of its customers' business, disclosing the details to no one without the direct authorization and request of the principal. When this duty of the trust company to its customers is fully understood it will be quite evident that no trust company can furnish to an underwriter a list of its customers or any statement as to the importance of their relations. Any trust company attempting to do this would commit business suicide.

It is even precarious for a trust company to furnish an underwriter with names of those who are not customers but who are believed to be good prospects. In certain instances, trust companies have distributed among a group of selected underwriters the names of prospects who have answered newspaper and magazine advertisements on life insurance trusts, but in carrying out such a policy unusual tact, discrimina-

tion and impartiality must be shown by both bank and underwriter.

An Unprejudiced Ally

No trust company can afford to play favorites among the underwriters. What it will do for one it must do for all—at least for all who measure up to certain minimum requirements of capability. It follows, therefore, that it cannot furnish leads, lists or confidential information of any character to one underwriter without making them available to others, and while this policy may make some friends for the trust company it may also breed ill will among bank customers.

The discovery of the prospect must rest with the underwriter. When the prospect has been found, the trust company should be introduced into the situation, not before. In fact, it is sometimes better for the underwriter to make one or two calls before the trust company is mentioned. Then it is time to bring the influence of the trust company to bear on the case. The underwriter usually has or should have one trust company with which he has had experience, and upon whose help he can rely. Sometimes the prospect has a strongly developed prejudice in favor of one institution and, if so, it may be unwise for the underwriter to attempt to introduce any other trust company. In any case, he should be certain that the trust company to which he goes, whether of his own or the prospect's choosing, will be able to help him in working out a business life insurance trust program for the prospect.

Every modern trust company has, as part of its organization, a system for developing new business.

Generally this takes the form of a new business department with one person in charge, usually an assistant trust officer. The personnel comprises outside solicitors who call upon prospects, and a clerical force who keep up the lists, make records of the calls and see that prospects are followed up at appropriate intervals. Every trust company has its own list of prospects, composed of its own customers and names furnished by life underwriters and others, and this list is followed by the trust company in a more or less intensive campaign.

Use of Printed Material

The business development work of the trust company includes the solicitation of life insurance trusts. This is beneficial to life underwriters as a whole, emphasizing, as it does, the value of life insurance and the need for added protection. All trust companies have booklets on wills, estates and life insurance trusts available for general distribution. These are attractively prepared and printed, sometimes with drawings, illustrations and charts, and in many instances are quite as emphatic in stressing the need for adequate insurance protection as they are in expounding the practical advantages of the life insurance trust. Every underwriter should know the contents of these booklets, and can use them with telling effect in interviews with prospects. Specimen forms of life insurance trust agreements are particularly useful in presenting the subject in concrete form.

Every wide-awake underwriter is sufficiently in touch with his policyholders to get the application for

additional insurance as soon as the need for it has been recognized. At times in its development work, when the trust company uncovers the need for added protection of one of its customers, it may call the attention of the underwriter, who has represented the insured, to that need, but by and large it is rather dangerous for the trust company to do so. The endorsement of a given underwriter by a trust company may operate prejudicially to some other underwriter who has also placed insurance with the prospect. It is particularly dangerous where the underwriter has not already established contact with the insured. The new underwriter may recommend a cancellation of some old insurance.

Methods of Coöperation

The trust company should encourage life insurance and should aid the underwriters to the fullest extent possible, but in so doing the trust company must be scrupulously careful that in helping one underwriter, it does not jeopardize or injure the position of another, or that it does not violate its own privileged and confidential relationship with the customer.

When the trust company has been selected, the underwriter should call upon the trust officer and the conversation between them should proceed about as follows:

Underwriter: "I am trying to get the firm of Bradley Brothers interested in a business life insurance trust. There are three brothers in that firm, all nearly the same age, and they carry no business insurance at all. I understand they do their banking with your

trust company; in fact, Arthur Bradley told me they had a loan running with you now."

Trust Officer: "We know these people very well and although we are not at liberty to tell you anything about their confidential business matters with us, I think I may safely say that they will give earnest attention to any recommendation you may make that has our approval."

At this point the underwriter can present the tentative program he has worked out, and discuss it item by item with the trust officer. The trust officer will study it and may make suggestions for improvement or modification that may occur to him. These may be because of the income or inheritance tax situation or some other phase of the subject. Very often the trust officer will have the help and collaboration of a tax expert, and a representative of the trust company's new business department should be present during the interview.

The life underwriter and the trust officer should cooperate wholeheartedly, but they should not interfere with each other. In developing life insurance trusts each must stay in his own territory. The life underwriter should not attempt to discuss wills, trust estates, inheritance taxes or income taxes in authoritative fashion unless qualified by study and experience to do so. These are problems with which the trust officer is called upon to deal in his daily routine. Similarly, the trust officer should not attempt to express authoritative opinions upon life insurance questions. The life underwriter is the best judge of the kind of policy suited to the needs of the prospect. He can

best advise concerning existing insurance. Neither life underwriter nor trust officer should enter the province of the other. The best interests of the prospect are always to be served, and until one or the other of the two agencies engaged in the joint venture of developing the insurance trust (that is, the life underwriter and the trust officer) shows that he is serving a selfish interest or that the best interests of the prospect call for different advice, neither should express an opinion upon the subjects within the other's jurisdiction or question the soundness of the recommendations made.

All these relationships are highly confidential in character. The information imparted by the insured must be zealously safeguarded by both life underwriter and trust officer. When the life underwriter discloses the name of a prospect to the trust officer, the latter must guard that secret and must not disclose the name of the prospect to any other underwriter. When the two have collaborated, they must show due deference to the interests of each other and must not develop the prospect's case independently or with any competing agency. After the solicitation of a case has been begun, the life underwriter and trust officer must work together until the whole estate program of the prospect is concluded or until the solicitation as a joint enterprise is definitely abandoned and an understanding to that effect has been reached.

Tax Saving Not a Principal Argument

The development of life insurance trusts on the basis of tax saving is poor policy. It is true that there are occasions when a rearrangement of assets may

affect the amount of the tax liability. This is always justifiable and is sound business. Tax evasion is indefensible, but the number of cases in which any real tax saving can be effected is very small. It is also dangerous, because the arrangement which may result in a tax saving to-day may be altered by legislative enactment or court decision to-morrow. It is a mistake, therefore, for any life underwriter or trust officer to urge the establishment of a business life insurance trust for the sole reason that it is going to effect a saving in taxes. If the agreement is made operative and then the situation so changes that there is no tax saving or that the tax burden is thereby increased, the confidence of the prospect in the integrity of the underwriter and the trust officer will be destroyed. In recommending a business life insurance trust program, there is no harm in pointing out incidental tax savings that may result, but to use tax saving alone as the reason for the establishment of the business life insurance trust is sheer folly.

It is very desirable to have the proposal thoroughly agreed upon by the underwriter and the trust officer in all its details before it is finally submitted to the prospect. This is on the supposition that any proposal by the underwriter alone, no matter how fully discussed with the prospect, will probably need to be revised for final presentation after the representative of the trust company has been brought into the negotiations. Such written proposal prepared jointly by the underwriter and the new business representative or trust officer of the trust company should be delivered to the prospect and explained orally by these two rep-

resentatives, who should have a very thorough understanding as to the method of procedure in this important interview. The presence of the trust company's representative at that time is a silent but impressive endorsement of the whole plan.

Keeping the Proposal As Simple As Possible

It is well to remember that too many legal details will cloud the issue. The trust officer should be careful to avoid technicalities in the beginning and should discuss the fundamental points of the proposed program. As these are covered and the prospect's thorough comprehension of the plan is evident, the more technical subjects may be discussed and clarified. These should never be neglected or glossed over, but they may easily be overemphasized and made to assume an importance that detracts from the convincing presentation of the main points of the case.

From this point on, the case is one for collaboration. The underwriter should not proceed without the trust company or at least without keeping it informed of what he is doing. The trust company should not proceed without the underwriter. When the program has been approved by the prospect, the attorneys must be called in to prepare the agreement. At last the day for closing arrives.

Joint Work in Closing the Sale

The most effective means of closing the life insurance trust presentation is in the office of the trust company. The surroundings are dignified and congenial; the prospect is free from the interruptions of

telephone and urgent calls from business associates to which he is subject in his own office. The senior officers of the trust company are usually able to devote as much time as necessary to the discussion of the prospect's case, whereas it is impossible to get many of the officers of the trust companies to leave their desks sufficiently long to call on the prospects in their own office, particularly if that office is located at any distance from the trust company. The prospect can have all his questions authoritatively answered in that interview.

It is often difficult to get the prospects sufficiently interested to call at the office of the trust company; sometimes it is necessary to close the matter in the prospect's own office. This can be done by having the prospect sign the agreement and deliver the policies, which are then taken by the representative of the trust company to the office of the trust company for signature and receipt. Another convenient arrangement is to have an official representative of the trust company present to sign on the trust company's behalf.

These are the broad principles governing successful coöperation between the life underwriter and the trust officer. Because of its increasing prominence and its many ramifications, the third class of business life insurance which provides for transfer of ownership has been stressed throughout these closing chapters. The same principles of coöperation apply to business life insurance trusts placed for "shock" or "credit" purposes. In conclusion, let it be said that, if the life underwriter and trust officer concur in earnest desire

to serve the business interests of the country, details, complications and obstacles will not prevent adequate protection of the business interests, the survivors and the family through the business life insurance trust.

APPENDICES

APPENDIX I

SPECIMEN FORMS OF BUSINESS LIFE INSURANCE TRUST AGREEMENTS

It is with some hesitancy that the authors embody in this volume forms of business life insurance trust agreements. The forms presented may be justly criticized as not being sufficiently comprehensive. The wishes and intentions of the interested parties, with respect to such matters as valuation of partnership or stock interests, payment of balance of purchase price in case the insurance proceeds are insufficient, penalties for failure to maintain insurance in force and so on, are so varied and depend to such a large extent upon the facts and circumstances of each case that any set of forms of a comprehensive nature would fill a volume of its own. It is the belief and hope of the authors, however, that if the suggested forms are used in connection with the work sheet, the preparation of a satisfactory written agreement will not be difficult.

SOLE PROPRIETORSHIP FORM

This Agreement is made (*month, day, year*) between A, (referred to herein as the owner) B, C and D (who are referred to herein as the purchasers) and ——— Trust Company, a corporation organized and existing under the laws of ———, located in ———, Trustee.

A is the sole owner of the printing business conducted at ——— Street, ———, under the name and style of "Federal Press." B, C and D are employees of A in the conduct and management of said business

A has applied to the ——— Life Insurance Company for a policy of $——— of ordinary life insurance on his life, has paid the first premium thereon, has irrevocably assigned all his interest in the policy to the Trustee under the terms of this Agreement, has caused the Trustee to be named as beneficiary of said policy and has deposited the policy which has been issued by the company (No. —) with the Trustee to be held under the terms of this Agreement

PAYMENT OF PREMIUMS

A agrees to furnish the Trustee with funds to maintain this insurance in force.

COLLECTION OF POLICY PROCEEDS

Upon the death of A, the Trustee shall collect the amount due under said policy and shall hold the same as a trust fund. The Trustee shall thereupon cause an audit to be made of the books of the "Federal Press" as of the nearest convenient date, not more than 30 days in advance of the death of the owner. The Trustee shall thereupon fix or cause to be determined by any method which it considers fair the value of the "Federal Press" as a going business.

SALE OF BUSINESS TO EMPLOYEES

The employees agree to purchase the "Federal Press" as a going business, through the Trustee acting on their behalf, at the value so fixed, and in addition the employees agree to pay to the estate of the owner the full amount of premiums paid by A at the time of the issuance of the

life insurance policy and thereafter to maintain the same in force. The proceeds of the insurance policies in the hands of the Trustee shall be used by the Trustee in payment of the amount due by the employees to the owner for the sale of the business. The owner hereby agrees that upon payment to his estate of the amount due for the purchase of the business by the employees, his personal representative shall execute such papers of transfer, assignment, conveyance and release as may be necessary to vest full and complete title to the business of the "Federal Press" as a going concern, including real estate, accounts receivable and cash in bank, in the employees In case the proceeds of insurance are insufficient to pay the owner's estate in full for the business, the full amount of the proceeds shall be paid to the owner's estate on account and the employees agree to pay any balance due in semiannual installments of equal amount within five years of the death of the owner. Title to the business shall remain in the owner or shall be vested in the Trustee meantime as security for the balance of purchase price due by the employees and subject to the rights of the employees to complete the purchase. The management and control of the business shall be vested in the employees, however, until default in the payment of any installment of the purchase price when due. In case the proceeds of insurance are more than sufficient to pay the owner's estate in full for the business, the full amount of the proceeds shall be paid to the owner's estate anyhow.

GENERAL ADMINISTRATIVE PROVISIONS

In fixing the value of the business of the "Federal Press" as a going concern, the Trustee is authorized to employ and rely upon the advice of any person whom it may consider competent to render an opinion and to be guided by and follow the recommendations and judgment of such person or persons in arriving at the value of the business as a going concern. The value when fixed by the Trustee shall be final, conclusive and binding upon all parties in interest

and for any finding made in good faith the Trustee shall not be personally liable to any one The cost and expense of audit and appraisal shall be borne by the estate of the owner and the Trustee shall deduct the same and the Trustee's commission from the funds in its hands before making payment to the owner's estate

This Agreement is joint and several, the employees having agreed among themselves to assume the duties and obligations as purchasers under this Agreement in equal proportionate shares.

Simultaneously with the execution of this Agreement, the owner has executed a trust agreement with the ——— Trust Company as Trustee providing for the investment and management of the proceeds from sale of the business for the benefit of the owner's family. Whenever hereunder provision is made for the payment of funds to the owner's estate, it is contemplated that payment shall be made to the ——— Trust Company as Trustee under said trust agreement, or any amendment or modification thereof or any agreement substituted therefor.

TRUSTEE'S COMPENSATION

The Trustee shall be entitled to commissions to be deducted from the amount due the owner's estate at the following rates:—per cent.

(Signed) A
B
C
D
TRUST COMPANY

———————

President.

PARTNERSHIP FORM

Partners to Pay Premiums

This Agreement is made (*month, day, year*) between A, B, C and D, members of the firm of A & Company (who are referred to herein as the "partners") and the ——— Trust Company, a corporation organized and existing under the laws of ———, located in ———, Trustee.

Applications have been made by the partners for policies of insurance which have been issued by the companies named, in the amounts stated, and which have been deposited with the Trustee to be held under the terms of this Agreement.

Number	*Company*	*On the life of*	*Amount*

PAYMENT OF PREMIUMS

B, C and D have applied for the insurance and have paid the first premium on the policies issued on the life of A. B, C and D agree to furnish the Trustee with funds to maintain this insurance in force, contributions to premium fund to maintain the same to be furnished by the partners to the Trustee, in the following proportions: B—per cent, C—per cent, D—per cent.

A, C and D have applied for the insurance and have paid the first premium on the policies issued on the life of B. A, C and D agree to furnish the Trustee with funds to maintain this insurance in force, contributions to premium fund to maintain the same to be furnished by the

partners to the Trustee, in the following proportions: A—per cent, C—per cent, D—per cent.

A, B and D have applied for the insurance and have paid the first premium on the policies issued on the life of C. A, B and D agree to furnish the Trustee with funds to maintain this insurance in force, contributions to premium fund to maintain the same to be furnished by the partners to the Trustee, in the following proportions: A—per cent, B—per cent, D—per cent.

A, B and C have applied for the insurance and have paid the first premium on the policies issued on the life of D. A, B and C agree to furnish the Trustee with funds to maintain this insurance in force, contributions to premium fund to maintain the same to be furnished by the partners to the Trustee, in the following proportions: A—per cent, B—per cent, C—per cent.

COLLECTION OF POLICY PROCEEDS

All policies are made payable to the Trustee as beneficiary. Upon the death of any of said partners, the Trustee shall collect the amount due under the policies on the life of the decedent and shall hold the same as a trust fund. The Trustee shall thereupon cause an audit to be made of the books of the firm as of the nearest convenient date, not more than 60 days in advance of the death of the partner. The Trustee shall thereupon fix or cause to be determined by any method which it considers fair and just the value of the interest of the deceased partner in the firm, and shall use the proceeds of the insurance policies on the life of the deceased partner to retire his interest in the firm, as hereinafter more fully provided. The Trustee is hereby given an option on said interest for the benefit of the partners hereunder.

RETIREMENT OF PARTNERSHIP INTEREST

Upon the death of any partner the Trustee shall pay to the personal representative of the deceased partner, from

the proceeds of insurance on the life of said deceased partner, the cash value of the partnership interest of the deceased partner The personal representative of the deceased partner shall thereupon transfer, assign and set over all right, title and interest of the deceased partner to the firm and to the firm assets and shall execute and deliver to the surviving partners and to the Trustee full receipts and releases of all claim of the deceased partner for his interest in the firm. In case the proceeds of insurance on the life of the deceased partner are insufficient to retire the interests of the deceased partner in the firm, the surviving partners shall contribute any balance that may be necessary to make up the full value of the interests of the deceased partner, such contributions to be in proportion to the interests of the surviving partners in the firm.

Simultaneously with the execution of this Agreement, the partners have executed individual trust agreements with the ——— Trust Company as Trustee providing for the investment and management of the proceeds from sale of the business for the benefit of each partner's family. Whenever hereunder provision is made for the payment of funds to a deceased partner, it is contemplated that payment shall be made to the ——— Trust Company as Trustee under said trust agreement, or any amendment or modification thereof or any agreement substituted therefor.

The proceeds of sale of the interest of any partner and the proceeds of his interest in insurance on the lives of the other partners shall be held by the ——— Trust Company free of this trust but on the trusts set forth in the trust agreement of even date between such partner and such trust company.

GENERAL ADMINISTRATIVE PROVISIONS

Dividends on all policies shall be used in reduction of premiums.

In case the insurance proceeds are in excess of the amount of the purchase price for the value of the interest of the deceased partner, such excess shall be paid over to the surviving partners in the same proportions.

In fixing the value of the interest of any partner, the Trustee is authorized to employ and rely upon the advice of any person whom it may consider competent to render an opinion and to be guided by and follow the recommendations and judgment of such person or persons in arriving at the value of the interest of any partner. The value of the interest when fixed by the Trustee shall be final, conclusive and binding upon all parties in interest and for any finding made in good faith the Trustee shall not be personally liable to any one. The cost and expenses of audit and appraisal shall be borne by the estate of the deceased partner and the Trustee shall deduct the same and the Trustee's commission from the insurance money in its hands before making payment to the estate of the deceased partner.

In case of any change in the proportionate interests in the firm as above stated, the rights, liabilities and obligations of the partners shall be proportionately increased or diminished. In case of the failure or refusal of any partner to furnish his proportionate share of funds for premium payments within 30 days of the date when due, his interest in the policies and in premiums theretofore paid shall cease but his interest in the firm shall continue to be subject to the Agreement and he may be reinstated upon payment of arrearages and with the consent of the then surviving partners.

The Trustee on request of the partners may avail itself of and is hereby vested with the right to utilize the loan, cash surrender or fully paid values of the insurance policies for the proportionate benefit of the then surviving partners. The Trustee shall not be liable for the payment of premiums on the policies unless furnished with funds by the partners for that purpose or unless the Trustee

shall be able to avail itself of loan values of the policies to that end.

Upon the death of any partner, the Trustee shall ascertain the cash surrender values of the policies of insurance on the lives of the surviving partners and the surviving partners agree to pay to the Trustee for the account of the estate of the deceased partner, in the proportions in which they shall be interested, the proportionate interest of the deceased partner in the cash surrender values of said policies on the lives of the surviving partners, such payment to be made by the surviving partners in cash.

(For states other than New York):

This Agreement shall continue until the third death among the partners and shall then terminate but not until the terms hereof with respect to all payments due by the then surviving partner shall have been fully complied with.

(For New York):

This Agreement shall continue after the first death among the partners and until the second death among the partners and shall then terminate but not until the terms hereof with respect to all payments due by the then surviving partners shall have been fully complied with It is contemplated that upon the termination of the Agreement by limitation, the then surviving partners will enter into a new Agreement similar in its terms for the period permitted by law.

In case of the termination of this Agreement by limitation or by agreement of the partners, the then surviving partners shall be entitled to an interest in the policies on the lives of the then surviving partners or the cash surrender values of the same in the proportions in which they have contributed to premium payments on the same.

In the event of the liquidation or dissolution of the firm, the partners shall be entitled to proper proportionate interests in the insurance policies on the lives of the then surviving partners, based on the contributions to premium payments on the same made by each of them.

This Agreement is several and not joint and is binding upon the executors, administrators and assigns of the partners. It is not subject to revocation or withdrawal by any party in interest.

TRUSTEE'S COMPENSATION

The Trustee shall be entitled to commissions to be deducted from sums payable to the estates of the partners at the time of distribution of funds, at the following rates: — per cent.

(Signed) A
B
C
D
TRUST COMPANY

____
President.

CORPORATION FORM

Individuals to Pay Premiums

This Agreement is made (*month, day, year*) between A, B, C, D (referred to herein as the "participants") and the ——— Trust Company, a corporation organized and existing under the laws of ———, located in ———, Trustee.

A is the President of ——— Company and the owner of —— shares of its capital stock.

B is the Vice President and Treasurer of ——— Company and the owner of —— shares of its capital stock.

C is the Vice President of ——— Company and the owner of —— shares of its capital stock.

D is the Secretary of ——— Company and the owner of —— shares of its capital stock.

A, B, C and D have deposited with the Trustee certificates of the stock of the ——— Company in the amounts set opposite their names, duly endorsed in blank, to be held by the Trustee under the terms of this Agreement. The participants agree to deposit any additional or other stock of the corporation which they may acquire from time to time, whether as stock dividends or otherwise

Applications have been made by the participants for policies of insurance which have been issued by the companies named, in the amounts stated, and which have been deposited with the Trustee to be held under the terms of this Agreement.

Number	*Company*	*On the life of*	*Amount*

PAYMENT OF PREMIUMS

B, C and D have applied for the insurance and have paid the first premium on the policies issued on the life of A. B, C and D agree to furnish the Trustee with funds to maintain this insurance in force, contributions to premium fund to maintain the same to be furnished by the participants to the Trustee, in the following proportions: B—per cent, C—per cent, D—per cent.

A, C and D have applied for the insurance and have paid the first premium on the policies issued on the life of B. A, C and D agree to furnish the Trustee with funds to maintain this insurance in force, contributions to premium fund to maintain the same to be furnished by the participants to the Trustee, in the following proportions: A—per cent, C—per cent, D—per cent.

A, B and D have applied for the insurance and have paid the first premium on the policies issued on the life of C. A, B and D agree to furnish the Trustee with funds to maintain this insurance in force, contributions to premium fund to maintain the same to be furnished by the participants to the Trustee, in the following proportions: A—per cent, B—per cent, D—per cent.

A, B and C have applied for the insurance and have paid the first premium on the policies issued on the life of D. A, B and C agree to furnish the Trustee with funds to maintain this insurance in force, contributions to premium fund to maintain the same to be furnished by the participants to the Trustee, in the following proportions: A—per cent, B—per cent, C—per cent.

COLLECTION OF POLICY PROCEEDS

All policies are made payable to the Trustee as beneficiary and the participants agree that no further change of beneficiary of any of said policies may be made without the consent of the Trustee. Upon the death of any of said participants, the Trustee shall collect the amount due under the policies on the life of the decedent and shall hold the same as a trust fund. The Trustee shall thereupon cause an audit to be made of the books of the corporation as of the nearest convenient date, not more than 60 days in advance of the death of the participant. The Trustee shall thereupon fix or cause to be determined by any method which it considers fair and just the value of the stock of the corporation owned by the participant and shall use the proceeds of the insurance policies on the life of the participant to purchase the stock of the participant on behalf of the surviving participants. The Trustee is hereby given an option on said stock for the benefit of the participants hereunder.

Title to stock shall remain in the participants and the right to vote and receive dividends and other rights ordinarily belonging to stockholders shall remain in the re-

spective participants until death, subject however to the deposit of the stock under this Agreement.

TRANSFER AND DELIVERY OF STOCK

Upon the death of A,—B, C and D shall be entitled to A's stock in the proportions which the stock holdings of B, C and D bear to each other.

Upon the death of B,—A, C and D shall be entitled to B's stock in the proportions which the stock holdings of A, C and D bear to each other.

Upon the death of C,—A, B and D shall be entitled to C's stock in the proportions which the stock holdings of A, B and D bear to each other.

Upon the death of D,—A, B and C shall be entitled to D's stock in the proportions which the stock holdings of A, B and C bear to each other.

Upon the death of any participant, title to his stock shall pass to the surviving participants subject to liability and security for any unpaid balance of purchase price that may be due and each of the participants directs his personal representative to execute any assignments or other instruments that may be necessary effectively to pass title. Upon payment of the balance of purchase price, the Trustee shall deliver the stock to the parties entitled thereto.

Simultaneously with the execution of this Agreement, the participants have executed individual trust agreements with the ——— Trust Company as Trustee providing for the investment and management of the proceeds from sale of the business for the benefit of the family of each participant. Whenever hereunder provision is made for the payment of funds to a participant, it is contemplated that payment shall be made to the ——— Trust Company as Trustee under said trust agreement, or any amendment or modification thereof or any agreement substituted therefor.

The proceeds of sale of the holdings of any participant and the proceeds of his interest in insurance on the lives

of the other participants shall be held by the ——— Trust Company free of this trust but on the trusts set forth in the trust agreement of even date between such participant and such trust company.

GENERAL ADMINISTRATIVE PROVISIONS

No participant shall sell, assign, pledge or otherwise dispose of his stock without the consent of the other participants.

Dividends on all policies shall be used in reduction of premiums.

In case the insurance proceeds are in excess of the amount of the purchase price for the stock, any excess shall be paid over to the surviving participants in the same proportions. In case the insurance proceeds are insufficient to pay in full for the stock, the surviving participants agree to pay over to the Trustee in the same proportions any balance of purchase price then due.

In fixing the value of the interest of any participant, the Trustee is authorized to employ and rely upon the advice of any person whom it may consider competent to render an opinion and to be guided by and follow the recommendations and judgment of such person or persons in arriving at the value of the stock of any participant. The value of the stock when fixed by the Trustee shall be final, conclusive and binding upon all parties in interest and for any finding made in good faith the Trustee shall not be personally liable to any one. The cost and expenses of audit and appraisal shall be borne by the estate of the insured and the Trustee shall deduct the same and the Trustee's commission from the insurance money in its hands before making payment to the estate of the insured.

In case of any change in the proportionate stock ownership of the company as above stated, the rights, liabilities and obligations of the participants shall be proportionately increased or diminished. In case of the failure or refusal of any participant to furnish his proportionate share of

funds for premium payments within 30 days of the date when due, his interest in the policies and in premiums theretofore paid shall cease but his stock shall continue to be subject to the Agreement, and he may be reinstated as a participant upon payment of arrearages and with the consent of the then surviving participants.

The Trustee on request of the participants may avail itself of and is hereby vested with the right to utilize the loan, cash surrender or fully paid values of the insurance policies for the proportionate benefit of the then surviving participants. The Trustee shall not be liable for the payment of premiums on the policies unless furnished with funds by the participants for that purpose or unless the Trustee shall be able to avail itself of loan values of the policies to that end.

Upon the death of any participant, the Trustee shall ascertain the cash surrender values of the policies of insurance on the lives of the surviving participants and the surviving participants agree to pay to the Trustee for the account of the estate of the insured, in the proportions in which they shall be interested, the proportionate interest of the deceased participant in the cash surrender values of said policies on the lives of the surviving participants, such payment to be made by the surviving participants in cash before delivery of the stock of the deceased participant to them.

(For states other than New York):

This Agreement shall continue until the third death among the participants and shall then terminate but not until the terms hereof with respect to all payments due by the then surviving participant shall have been fully complied with.

(For New York):

This Agreement shall continue after the first death among the participants and until the second death among the participants and shall then terminate, but not until the terms hereof with respect to all payments due by the then

surviving participants shall have been fully complied with. It is contemplated that upon the termination of the Agreement by limitation the then surviving participants will enter into a new Agreement similar in its terms for the period permitted by law.

In case of the termination of this Agreement by limitation or by agreement of the participants, the then surviving participants shall be entitled to an interest in the policies on the lives of the then surviving participants or the cash surrender values of the same in the proportions in which they have contributed to premium payments on the same.

In the event of the liquidation or dissolution of the corporation, the participants shall be entitled to the return of the stock deposited by them respectively and to proper proportionate interests in the insurance policies on the lives of the then surviving participants, based on the contributions to premium payments on the same made by each of them.

This Agreement is several and not joint and is binding upon the executors, administrators and assigns of the participants. It is not subject to revocation or withdrawal by any party in interest.

TRUSTEE'S COMPENSATION

The Trustee shall be entitled to commissions to be deducted from sums payable to the estates of the participants at the time of distribution of funds, at the following rates: — per cent.

(Signed) A
B
C
D
TRUST COMPANY

____
President.

CORPORATION FORM

Corporation to Pay Premiums

This Agreement is made (*month, day, year*) between A, B, C and D, participants in the X Corporation (referred to herein as the "Corporation") and the ——— Trust Company, a corporation organized and existing under the laws of ———, located in ———, Trustee.

A is the President of the X Corporation and the owner of —— shares of its capital stock.

B is the Vice President and Treasurer of the X Corporation and the owner of —— shares of its capital stock.

C is the Vice President of the X Corporation and the owner of —— shares of its capital stock.

D is the Secretary of the X Corporation and the owner of —— shares of its capital stock.

A, B, C and D have deposited with the Trustee certificates of stock of the X Corporation in the amounts set opposite their names, duly endorsed in blank, to be held by the Trustee under the terms of this Agreement. The participants agree to deposit any additional or other stock of the Corporation which they may acquire from time to time, whether as stock dividends or otherwise.

Applications have been made by the Corporation for policies of insurance which have been issued by the companies named, in the amounts stated, and which have been deposited with the Trustee to be held under the terms of this Agreement.

Number	*Company*	*On the life of*	*Amount*

PAYMENT OF PREMIUMS

The X Corporation has paid the first premium on the policies issued on the lives of the participants and agrees

to furnish the Trustee with funds to maintain the insurance in force during the life of this Agreement.

COLLECTION OF POLICY PROCEEDS

All policies are made payable to the Trustee as beneficiary and the participants and the Corporation agree that no further change of beneficiary of any of said policies may be made without the consent of the Trustee Upon the death of any of said participants, the Trustee shall collect the amount due under the policies on the life of the decedent and shall hold the same as a trust fund. The Trustee shall thereupon cause an audit to be made of the books of the Corporation as of the nearest convenient date, not more than 60 days in advance of the death of the participant. The Trustee shall thereupon fix or cause to be determined by any method which it considers fair and just the value of the stock of the Corporation owned by the participant and shall use the proceeds of the insurance policies on the life of the participant to purchase the stock of the participant, on behalf of the Corporation, for retirement. The Trustee is hereby given an option on said stock for the benefit of the Corporation.

Title to stock shall remain in the participants and the right to vote and receive dividends and other rights ordinarily belonging to stockholders shall remain in the respective participants until death, subject, however, to the deposit of the stock under this Agreement.

TRANSFER AND DELIVERY OF STOCK

Upon the death of any participant, title to his stock shall pass to the Corporation subject to liability and security for any unpaid balance of purchase price that may be due and each of the participants directs his personal representative to execute any assignments or other instruments that may be necessary effectively to pass title. Upon

payment of the balance of purchase price the Trustee shall deliver the stock to the Corporation.

Simultaneously with the execution of this Agreement, the participants have executed individual trust agreements with the ——— Trust Company as Trustee providing for the investment and management of the proceeds from sale of the business for the benefit of the family of each participant. Whenever hereunder provision is made for the payment of funds to a participant, it is contemplated that payment shall be made to the ——— Trust Company as Trustee under said trust agreement, or any amendment or modification thereof or any agreement substituted therefor.

The proceeds of sale of the holdings of any participant and the proceeds of his interest in insurance on the lives of the other participants shall be held by the ——— Trust Company free of this trust but on the trusts set forth in the trust agreement of even date between such participant and such trust company.

GENERAL ADMINISTRATIVE PROVISIONS

No participant shall sell, assign, pledge or otherwise dispose of his stock without the consent of the other participants.

Dividends on all policies shall be used in reduction of premiums.

In case the insurance proceeds are in excess of the amount of the purchase price for the stock, any excess shall be paid over to the Corporation. In case the insurance proceeds are insufficient to pay in full for the stock, the Corporation agrees to pay over to the Trustee any balance of purchase price then due.

In fixing the value of the interest of any participant the Trustee is authorized to employ and rely upon the advice of any person whom it may consider competent to render an opinion and to be guided by and follow the recom-

mendations and judgment of such person or persons in arriving at the value of the stock of any participant. The value of the stock when fixed by the Trustee shall be final, conclusive and binding upon all parties in interest and for any finding made in good faith the Trustee shall not be personally liable to any one The cost and expenses of audit and appraisal shall be borne by the estate of the insured and the Trustee shall deduct the same and the Trustee's commission from the insurance money in its hands before making payment to the estate of the insured.

The Trustee on request of the Corporation may avail itself of and is hereby vested with the right to utilize the loan, cash surrender or fully paid values of the insurance policies for the benefit of the Corporation. The Trustee shall not be liable for the payment of premiums on the policies unless furnished with funds by the Corporation for that purpose or unless the Trustee shall be able to avail itself of loan values of the policies to that end.

(For states other than New York):

This Agreement shall continue until the third death among the participants and shall then terminate but not until the terms hereof with respect to all payments due by the Corporation shall have been fully complied with.

(For New York):

This Agreement shall continue after the first death among the participants and until the second death among the participants and shall then terminate but not until the terms hereof with respect to all payments due by the Corporation shall have been fully complied with. It is contemplated that upon the termination of the Agreement by limitation the then surviving participants will enter into a new Agreement similar in its terms for the period permitted by law.

At the time of this Agreement, the Corporation has a surplus which, together with the proceeds of the insurance policies on the life of the participants deposited under this agreement is more than sufficient to retire the stock interest

of any participant on any reasonable basis of valuation. This Agreement is conditioned upon the existence of a surplus sufficient in amount for the purpose of this Agreement at the time performance thereof is required.

In the event of the liquidation or dissolution of the Corporation, the participants shall be entitled to the return of the stock deposited by them respectively and to proper proportionate interests in the insurance policies on the lives of the then surviving participants, in proportion to their respective stock ownerships in the Corporation.

This Agreement is several and not joint and is binding upon the executors, administrators and assigns of the participants. It is not subject to revocation or withdrawal by any party in interest.

TRUSTEE'S COMPENSATION

The Trustee shall be entitled to commissions to be deducted from sums payable to the estates of the participants at the time of distribution of funds, at the following rates: — per cent.

(Signed) A
B
C
D

TRUST COMPANY

____

President.

NOTE.—This form of agreement makes no provision for allowance to estate of deceased stockholder on account of premiums paid by corporation on or cash surrender value of policies on lives of surviving stockholders.

APPENDIX II

SCHEDULE OF POINTS TO BE COVERED IN NEGOTIATING BUSINESS LIFE INSURANCE TRUST

A. Life Insured

1. Life or lives to be insured
2. Amount of insurance
3. Is the amount of insurance to remain stationary, or is it to be automatically increased at the end of two, four, six years?
4. Kind of policy: straight life, 20-year endowment
5. Is the insurance all new insurance or can use be made of some already existing policies?

B. Application

1. Who should apply for insurance?
2. Is there anything to be gained by having insurance applied for by insured and assigned? Is this safe?

C. Payment of Premiums

1. Who will pay premiums?
2. Shall policies contain automatic loan to pay premiums provision?
3. Dates and amounts of contributions to premium fund
4. Rights of insured in loan and cash surrender values
5. Rights of firm or corporation in loan and cash surrender values
6. Rights of trustee in loan and cash surrender values of policies
7. Reimbursement for premium outlay

8. Should party who has been in default on premium payments be entitled to reinstatement? If so, on what terms?
9. Should party in default receive reimbursement for payments made? If so, when?

D. Maturity of Policy and Distribution of Policy Proceeds

1. Who is to be the beneficiary of the policy?
2. What method to fix values of stock or partnership interest should be followed?
3. How is good will to be figured?
4. Retirement of decedent's interest
5. Plan for payment of balance due
6. Should stock be deposited with trustee?
7. Should stock certificates be endorsed?
8. In what shares and proportions does the stock pass to the parties in interest?

E. Duration of Agreement, Power to Revoke or Alter Its Terms

1. How long should agreement run? Should extension beyond original term be permitted?
2. Where is the voting control of stock to be vested meantime?
3. Who are to receive dividends?
4. What are the rights of the parties to be in case of extraordinary or stock dividends?
5. What happens to the policies on the dissolution of the business?
6. Should agreement be revocable? If so, under what conditions?
7. Should parties be permitted to withdraw stock from trustee? If so, for what purposes?
8. Rights of parties if agreement cannot be completed after it has been partially performed
9. Should right to change beneficiary be reserved?

10. Admission of new parties who did not want to join when agreement was made or were not then partners or stockholders
11. Changes in amount of insurance as a result of changes in stock ownership
12 Consequences of failure to remit premium contribution
13. Right of other parties to make payments in lieu of party in default
14. After the interest of the deceased partner or stockholder has been liquidated, what disposition of the resulting fund should be made by the trustee?

TABLE OF CASES

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